

Cite as Det. No. 18-0246, 39 WTD 134 (2020)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0246
)	
... )	Registration No. . . .
)	

[1] RULE 170; RCW 82.04.070: RETAILING B&O TAX – PRIME CONTRACTOR – GROSS INCOME. Taxpayer is a prime contractor subject to assessment based on gross contract price stated in the agreement, along with any costs that were additions to the gross contract price. Taxpayer would not owe tax on costs that were specifically negotiated as falling outside of the construction contract and that were incurred by the Customer directly without going through Taxpayer.

[2] RCW 82.08.130: TAX PAID AT SOURCE DEDUCTION – SUBSTANTIATION. Tax paid at source deduction is allowed only if the taxpayer keeps and preserves records to substantiate the 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.

Casselman, 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 assessed on the amount of the total construction project cost instead of contract sum. Taxpayer further asserts it is entitled to additional “tax paid at source” deductions. We grant Taxpayer’s petition in part and deny in part.<sup>1</sup>

ISSUES

1. Under RCW 82.04.070 and WAC 458-20-170 (Rule 170), did the Department err when it calculated Taxpayer’s measure of tax using the total construction project costs rather than the contract sum?
2. Under RCW 82.08.130 and WAC 458-20-254 (Rule 254), did Taxpayer substantiate additional “tax paid at source” deductions?

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

FINDINGS OF FACT

Taxpayer is a Washington corporation engaged in the business of providing general contractor services. Taxpayer contracted with . . . (Customer) to build a [hotel in] Washington. Taxpayer entered into a contract titled “Standard Form of Agreement between Owner and Contractor” (Agreement) on January 19, 2015.<sup>2</sup> The Agreement documents that the Customer will pay the Taxpayer the contract sum in a stipulated amount of \$ . . . . The Agreement is silent regarding architect and engineering services. Customer hired and paid the Architect separate from Customer’s contract with Taxpayer. Customer also purchased furniture, fixtures, and equipment (FF&E) for the project. The total amount on the construction loan disbursed to Customer was \$ . . . .<sup>3</sup> Customer paid all invoices on the project.

In 2017, the Department’s Audit Division (Audit) commenced a review of Taxpayer’s books and records for the period of October 1, 2014, through June 30, 2017 (Audit Period). Based on its review, Audit determined the Taxpayer’s books were incomplete and issued an estimated assessment on October 20, 2017, of \$ . . . .<sup>4</sup> This assessment was based in part on documentation provided by Customer. Audit determined that Taxpayer incorrectly reported income under the Wholesaling B&O tax classification, reclassified that income to Retailing B&O tax classification, and subjected it to retail sales tax. Audit then reviewed the cost breakdown prepared by Customer for the project in question. Based on the cost breakdown, Audit determined that the original contract price of \$ . . . had increased and that the total construction cost was actually \$ . . . .<sup>5</sup> Audit also allowed a credit to Taxpayer for retail sales and use tax paid by Customer, as supported by documentation provided to the auditor.

Taxpayer asserted during the audit, and again in the petition for correction of the assessment, that a number of the itemized expenses<sup>6</sup> contained in the records were direct costs of the Customer and were paid directly by Customer. As such, Taxpayer believes that these items should not be included in its measure of tax and thus, should not be subject to retailing B&O tax or retail sales tax. Taxpayer and Customer agree that Customer was liable for, and did pay for Architect and Engineering costs, and FF&E costs. Customer submitted signed documentation confirming that the total contract sum was \$ . . . and that the additional “soft costs” that Audit assessed against Taxpayer, were Customer’s responsibility and outside the contract between Taxpayer and Customer.<sup>7</sup> Taxpayer further asserts that it is entitled to additional “tax paid at source” deductions.

<sup>2</sup> . . .

<sup>3</sup> At the time Taxpayer completed work on the project, the total disbursement to Customer was \$ . . . .

<sup>4</sup> The assessment, Document No. . . . was comprised of \$ . . . in retail sales tax, \$ . . . in retailing B&O tax, a credit for \$ . . . in wholesaling B&O tax, \$ . . . in interest, and a 5% assessment penalty of \$ . . . .

<sup>5</sup> Audit determined that the total contract price should include charges for FF&E, Architect & Engineering services, and Developer’s overhead and profit (OH&P).

<sup>6</sup> Specifically, FF&E, Architect and Engineering costs, and Developer’s OH&P.

<sup>7</sup> The total amount of “soft costs” that were outside of the contract sum is \$ . . . . Customer provided the following soft cost breakdown on which Audit relied in reaching its estimated assessment:

Land	\$ . . .
FF&E	\$ . . .
Architect and Engineering	\$ . . .
Developer’s OH&P	\$ . . .
Appraisal Fee	\$ . . .
Interest Reserves	\$ . . .

ANALYSIS

Washington imposes B&O tax upon the privilege of engaging in business activities in this state. RCW 82.04.220(1). The measure of the tax as well as the tax rate vary depending upon the nature, or classification, of the activity. *Id.* Retailing B&O tax is due on all retail sales. RCW 82.04.250.

RCW 82.08.020 imposes retail sales tax on each retail sale in Washington. The seller must collect sales tax from the buyer, and then remit the collected tax to the Department. RCW 82.08.050.

The term “retail sale” is defined in RCW 82.04.050 and includes 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 . . . under, upon, or above real property of or for consumers. . . .

RCW 82.04.050(2)(b) (emphasis added).

**1. Taxpayer’s measure of tax is the contract price and not total construction costs.**

RCW 82.04.051 defines the term “services rendered in respect to,” for purposes of RCW 82.04.050, as “those services that are directly related to the constructing . . . of buildings . . . and that are performed by a person who is *responsible for the performance of* the constructing. . . activity.” RCW 82.04.051(1) (emphasis added).

RCW 82.04.051(4) defines “responsible for the performance” as follows, in pertinent part:

As used in this section “responsible for the performance” means that the person is obligated to perform the activities, either personally or through a third party. A person who reviews work for a consumer, retailer, or wholesaler but does not supervise or direct the work is not responsible for the performance of the work.

Under RCW 82.04.051(4), “responsible for the performance” means that the person is obligated to perform the activities, either personally or through a third party. Rule 170 is the administrative rule explaining the taxation of the construction business. It defines the term "constructing, repairing, decorating or improving of new or existing buildings or other structures," as:

Insurance	\$ . . .
Title & Date downs	\$ . . .
Inspections	\$ . . .
Sales Tax	\$ . . .
[Hotel Chain] Fees	\$ . . .

. . . [T]he sale of or charge made for all service activities rendered in respect to such constructing, repairing, etc., regardless of whether or not such services are otherwise defined as “sale” by RCW 82.04.040 or “sales at retail” by RCW 82.04.050. Hence, for example, such service *charges as engineering fees, architectural fees or supervisory fees are within the term when the services are included within a contract* for the construction of a building or structure. The fact that the charge for such services may be shown separately in bid, contract or specifications does not establish the charge as a separate item in computing tax liability.

WAC 458-20-170(1)(e) (emphasis added). Thus, under Rule 170, the measure of tax . . . [includes] engineering and architectural fees when those services are included within a contract. The determinative factor for the inclusion of a cost in the total project cost is whether the entity providing services was liable for the expense, not who paid for the item. We have held that under Rule 170, direct payments by the owner/consumer to the third parties who contracted with the taxpayer to provide services and/or supplies were properly assessed against the taxpayer as gross income. Det. No. 93-166, 14 WTD 022 (1994).

Retailing B&O tax is imposed on the gross proceeds of sales, multiplied by the applicable B&O tax rate. RCW 82.04.250. “Gross proceeds of sale” is defined as:

[T]he value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.070.

Rule 170(3)(b) recognizes that where a gross contract price is **not** stated in a contract, the total construction costs is the measure of B&O tax:

*Where no gross contract price is stated* in any contract or agreement between the builder and the property owner, then the measure of business and occupation tax is the total amount of construction costs, including any charges for licenses, fees, permits, etc., required for the construction and paid by the builder.

WAC 458-20-170(3)(b) (emphasis added). Rule 170(4)(a) defines the measure of retail sales tax similar to how Rule 170(3)(b) defines the measure of B&O tax and reads as follows:

Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. *Where no gross contract price is stated*, the measure of sales tax is the total amount of construction costs including any charges from licenses, fees, permits, etc., required for construction and paid by the builder.

Rule 170(4)(a) (emphasis added). Here, a gross contract price was stated in the signed Agreement between Taxpayer and the Customer. Taxpayer and Customer agreed that Taxpayer was not liable for the FF&E costs, and the architectural and engineering costs. [There is no evidence of architectural and engineering costs, or FF&E costs being included in the contract.] In other words, those costs were outside of the contract between Taxpayer and Customer. Customer was the entity responsible for purchasing FF&E, and for hiring and paying the architect in this case and Customer was the entity solely liable for those expenses. Further, the Customer's OH&P should not have been included in the Taxpayer's measure of tax as it is outside of the contract between Taxpayer and Customer. Thus, the assessment should have been made on the gross contract price stated in the Agreement, along with any costs that could be viewed as additions to the gross contract price.<sup>8</sup> . . . Accordingly, we grant Taxpayer's petition on this issue as to FF&E, architect firm expenses, and the [Customer's] OH&P.

## **2. Taxpayer did not substantiate additional tax paid at source deductions.**

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.*

RCW 82.08.130 (emphasis added). Thus, a tax paid at source deduction is available, but a taxpayer must produce records to support it. Audit allowed all sales tax paid at source deductions that were substantiated by [Taxpayer's] records. Audit advised Taxpayer that it would increase the amount of tax paid at source deduction if Taxpayer could document any additional sales taxes paid at source. Taxpayer did not provide documentation to substantiate additional deductions. Accordingly, we deny Taxpayer's petition on this issue.

## DECISION AND DISPOSITION

Taxpayer's petition is denied in part and granted in part. We deny the petition with respect to Taxpayer's claim that it is due additional tax paid at source deductions. We grant the petition with respect to the measure of tax used. We agree with Taxpayer that the correct measure of tax is the gross contract price stated in the agreement.

Dated this 11th day of September 2018.

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<sup>8</sup> In this case, no evidence of such change order, or addition exists.