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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. 01-184
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

RCW 82.08.050, RCW 82.04.050, RCW 82.04.051; RULE 170: 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.

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:

Taxpayer protests the reclassification of kitchen and bath remodel design work from the service-other business and occupation ("B&O") to the retailing B&O and retail sales tax classifications.[1]

FACTS:

Lewis, A.L.J. -- Taxpayer, a Washington corporation, does residential kitchen and bathroom remodels. Taxpayer performs both design services and actual construction work. Taxpayer explained that each sale begins with a fact finding discussion with the customer. During the initial meeting with the customer, Taxpayer explains the range of services it offers. If the customer shows interest in the services that Taxpayer offers, an appointment is made for one of

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

Taxpayer's representatives to visit the customer's home. The information gathered during the home visit provides the information that Taxpayer needs to give the customer a "ballpark" estimate of the cost of the remodel job. Taxpayer does not charge the customer for the home visit or the "ballpark" bid estimate.

Next, Taxpayer develops a conceptual design. Taxpayer's development of a conceptual design serves two purposes: 1) it allows the customer to better visualize the remodel plan and 2) allows Taxpayer to detail the labor and materials necessary to estimate and bid the job.[2] Production of a conceptual design is a costly undertaking with no assurance that the customer will purchase Taxpayer's remodel services. Thus, Taxpayer charges the customer to develop conceptual design plans. Taxpayer requires the customer to sign a "Design Retainer Agreement" and pay a non refundable retainer of between $500 and $1,500.

. . .

In those cases where the customer has chosen not to hire Taxpayer for the remodel work, Taxpayer reported the conceptual design fees under the service-other B&O tax classification.[3]

In those cases where the customer chooses to have Taxpayer do the remodel work a Construction Contract ("the Contract") is completed and signed by both Taxpayer and the customer. The Contract sets out the contract price and when the payments are required.

. . .

According to the Construction Contract, the purchase amount subject to retail sales tax is determined by subtracting the amount of the design retainer fee previously paid.[4]

The Audit Division of the Department of Revenue ("Department") audited Taxpayer's business records for the period January 1, 1997 through September 30, 2000. On June 11, 2001, the Department issued a $ . . . tax assessment. Most of the assessment resulted from the Audit Division's reclassification of Taxpayer's Conceptual Design fees from the service-other B&O tax classification to the retailing B&O and imposing retail sales tax on the Conceptual Design fees. The Audit Division made the reclassification finding that the design fees were part of the retail construction contract. In making that determination the Audit Division relied on the wording of the "Design Retainer Agreement," "Construction Contract," and the fact that the design fee charges were "carried-forward from the "Design Retainer Agreement" and included as part of the Construction contract amount. Specifically, the Audit Division relied on that portion of the "Design Retainer Agreement" that stated:

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[2] According to Taxpayer, conceptual designs are not complete design plans. They are not complete enough for either a major construction project or even some building related permit requirements.

[3] Conceptual Design fees that did not result in contracts and were reported under the service-other B&O tax classification are not in dispute.

[4] Taxpayer reported the design retainer fees under the service-other B&O tax classification.

> If the client contracts with [Taxpayer] to execute the construction phase of this project within one year of the date of this agreement, the total amount of such retainers and/or deposits will be applied to the contract amount.

The Audit Division maintains that this supports a finding that the parties originally contemplated Taxpayer would do both the design and construction. The last section of the Design Retainer Agreement is titled Rights to Design and Drawings and stated in part that:

> [Taxpayer] shall retain rights to the design and drawings which are produced in connection with this agreement. All drawings, specifications and copies thereof furnished by [Taxpayer] are, and shall remain, its property . . . .

Finally, Section 2.1 of the "Construction Contract" stated:

> The project is the total design and construction for which [Taxpayer] is responsible, including all professional design services and all labor, materials, and equipment used or incorporated in such design and construction as called out in the drawings, specifications, and other contract documents.

The Audit Division also noted that the "Construction Contract" stated that it was for "design and construction," which supports a finding that the parties originally contemplated Taxpayer would do both. Taxpayer disagreed with the tax assessment. On July 7, 2001, Taxpayer filed a petition requesting correction of the assessment. The Appeals Division held an in-person hearing on September 27, 2001. During the in-person hearing Taxpayer explained that its actual working relationship with its customer was different from what the two written agreements suggested. Taxpayer strenuously maintained that the Audit Division erred in concluding that the Design fees were part of the retail construction agreement because:

- The "Design Fee Retainer Agreement" and the "Construction Contract" are two separate agreements negotiated and agreed to at two separate times.

- The Design fee retainer amount was only included in the Construction Contract to give the customer a full and complete accounting of all the funds Taxpayer had collected.

ISSUE:

Whether design fees collected under a written agreement separate from and signed prior to a construction contract are part of the construction contract and require payment of retailing B&O tax and retail sales tax?

DISCUSSION:

Generally, a person must collect retail sales tax on the gross amounts it charges to construct, repair, or improve new or existing buildings for [a] consumer. RCW 82.08.050(2).[5] The person must also pay Retailing B&O tax on the gross amounts charged the consumer. RCW 82.04.050 and .220, WAC 458-20-170 ("Rule 170"). A person that provides a service, including professional services such as engineering or design services, under most circumstances, is not required to collect retail sales tax, but must pay Service and Other Activities B&O tax on the gross income derived from providing those services. In some circumstances involving construction activities, however, a person who provides a service, normally taxable at the Service and Other Activities B&O rate would be taxed, instead, at the Retailing B&O rate and would be required to collect retail sales tax on the amounts a consumer pays that person for those services. The Audit Division believes the services provided by Taxpayer were performed in such a circumstance.

In 1999, the legislature amended chapter 82.04 RCW to clarify what tax was due in such circumstances. Specifically, the legislature enacted RCW 82.04.051 to explain the taxation of "services rendered in respect to construction." RCW 82.04.051 states:

> (1) As used in RCW 82.04.050, the term "services rendered in respect to" means those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. The term does not include services such as engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services provided to the consumer of, or person responsible for performing, the constructing, building, repairing, improving, or decorating services.
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> (2) A contract or agreement under which a person is responsible for both services that would otherwise be subject to tax as a service under RCW 82.04.290(2) and also constructing, building, repairing, improving, or decorating activities that would otherwise be subject to tax under another section of this chapter is subject to the tax that applies to the predominant activity under the contract or agreement.
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> (3) 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

[5] RCW 82.04.050(2) defines a "sale at retail" to include:

> [T]he sale of or charge made for tangible personal property consumed and/or for labor or 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 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, . . .

(Emphasis added.)

> 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.
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> (4) 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. A person who is financially obligated for the work, such as a bank, but who does not have control over the work itself is not responsible for the performance of the work.

The intent of the legislature in adopting RCW 82.04.051 is clearly stated in paragraphs 1, 2, and 3 of ch. 212, Laws of 1999:

> (1) The legislature finds that the taxation of "services rendered in respect to constructing buildings or other structures" has generally included the entire transaction for construction, including certain services provided directly to the consumer or owner rather than the person engaged in the performance of the constructing activity. Changes in business practices and recent administrative and court decisions have confused the issue. It is the intent of the legislature to clarify which services, if standing alone and not part of the construction agreement, are taxed as retail or wholesale sales, and which services will continue to be taxed as a service.
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> (2) It is further the intent of the legislature to confirm that the entire price for the construction of a building or other structure for a consumer or owner continues to be a retail sale, even though some of the individual services reflected in the price, if provided alone, would be taxed as services and not as separate retail or wholesale sales.
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> (3) Therefore, the intent of this act is to maintain the application of the law and not to extend retail treatment to activities not previously treated as retail activities. Services that are otherwise subject to tax as a service under RCW 82.04.290(2), including but not limited to engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services, remain subject to tax as a service under RCW 82.04.290(2), if the person responsible for the performance of those services is not also responsible for the performance of the constructing, building, repairing, improving, or decorating activities. Additionally, unless otherwise provided by law, a person entering into an agreement to be responsible for the performance of services otherwise subject to tax as a service under RCW 82.04.290(2), and subsequently entering into a separate agreement to be responsible for the performance of constructing, building, repairing, improving, or decorating activities, is subject to tax as a service under RCW 82.04.290(2) with respect to the first agreement, and is subject to tax under the appropriate section of chapter 82.04 RCW with respect to the second agreement, if at the time of the first agreement there was no contemplation by the parties, as evidenced by the facts, that the agreements would be awarded to the same person.

(Emphasis added.)

RCW 82.04.051 was enacted to explain the language originally contained in RCW 82.04.050, which defines activities that are subject to Retailing B&O tax and retail sales tax. Statutes, such as RCW 82.04.051 that have a clarifying or remedial purpose have retroactive application. Magula v. Benton Franklin Title Co., Inc., 131 Wn.2d 171, 182, 930 P.2d 307 (1997). Accordingly, we will apply the provisions of RCW 82.04.051 to determine whether the Audit Division properly classified Taxpayer's activities as retail services.

RCW 82.04.051 provides that a contract for services, such as design work, will not be combined with a subsequent contract and taxed as a single activity "if at the time of the first contract or agreement it was not contemplated by the parties, . . . , that the same person would be awarded both contracts." That, however, is not the case here.

. . .

The written documents that Taxpayer uses to memorialize its agreement with its client support a finding that at the time the design work is done both parties contemplate a . . . remodel job. The "Design Retainer Agreement" states:

> If the client contracts with [Taxpayer] to execute the construction phase of this project within one year of the date of this agreement, the total amount of such retainers and/or deposits will be applied to the contract amount.

Similarly, we find that the wording of Section 2.1 of the "Construction Contract," stating that it was for "design and construction" supports a finding that the parties contemplated that Taxpayer would do both the design and construction work.

Based on the fact that a future retail construction job was contemplated at the time that the design work was done, we find that the conceptual designs were rendered "in respect to" the construction contracts, and thus are part of the construction jobs. Accordingly, the design fees are subject to the Retailing B&O tax classification and collection of retail sales tax.

DECISION:

Taxpayer's petition is denied.

DATED this 12th day of December, 2001.