Cite as 10 WTD 282 (1990)

BEFORE THE INTERPRETATION AND APPEALS DIVISION

DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 89-248 |
| . . . | ) | Registration No. . . . |
| | ) | . . ./Audit No. . . . |

[1] RULE 170: RCW 82.04.050 -- RETAIL SALES -- SERVICES "IN RESPECT TO" CONSTRUCTION. The statute does not require that services rendered "in respect to" construction be rendered within a written contract for construction in order to be taxable as retail sales; therefore the Department of Revenue cannot impose that requirement.

[2] RULE 223, RULE 170: RETAIL SALES -- AMOUNTS PAID BY CONTRACTOR AND "REIMBURSED" BY BUYER -- SUBJECT TO SALES TAX. Amounts subject to sales tax that are paid by a contractor and "reimbursed" by the buyer are properly subject to sales tax, and such tax cannot be credited against the sales tax due on the contractor's fee.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF CONFERENCE: . . .

NATURE OF ACTION:

Taxpayer petitions for correction of assessment reclassifying a fee received from the Service and Other category of the business and occupation tax to the Retailing category, and imposing retail sales tax on it.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is in the residential construction and remodeling business. Its records were audited for the period January 1, 1984, through June 30, 1987. Taxpayer objects to that part of the assessment asserting Retailing business and occupation tax and retail sales tax due on a fee it received from a partnership.

In 1984 the partnership [buyer] engaged taxpayer to "undertake a joint development effort" for the construction of an apartment building on its behalf. According to the affidavit of the managing partner of the partnership:

> 3. For such development services, [taxpayer] was to be paid a developer's fee;
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> 4. [Taxpayer] was jointly responsible with [another entity] for performing feasibility studies for the Project and was also responsible for arranging for the acquisition of extra land for the Project and for the financing of the purchase of the extra land and construction of improvements for the Project and also for helping the architect for the Project with the plans;
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> 5. [Buyer] was not obligated to engage [taxpayer] as its contractor for the Project; however it did so [in September of 1985], the date on which [the two] executed the construction contract for the Project;
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> 6. If [Buyer] had not engaged [taxpayer] as its contractor for the Project, [Buyer] would have been obligated to pay to [taxpayer] the developer's fee;
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> 7. The reference in the construction contract to a "Contractor's Fee" was not meant to infer that the fee was being paid for something other than the development services performed by [taxpayer] as recited in paragraph 4 above.

(Affidavit of [managing partner dated May of 1988].)

The construction contract, signed [in September 1985], is between the buyer and taxpayer as contractor. It provides that the Contractor's Fee is to be split between taxpayer and another entity.

According to a memo from the managing partner of the buyer:

> The $170,000 paid to [taxpayer], as the contractor's fee, will be paid in two equal amounts, 50% to be paid when we receive a Certificate of Occupancy, and the other 50% with the final payment. This method of payment is typical inasmuch as [taxpayer] is responsible for the construction of the project. In keeping with [other entity's] policy, the amount due [it] will be paid out over 60 months. [Other entity] has already completed the feasibility studies, arranged for construction financing, and will arrange for permanent financing as well as the ongoing management of both the project and the partnership.

According to a second affidavit submitted by the managing partner of the partnership, the $170,000 fee to taxpayer was set when it entered into the agreement with the partnership in 1984. Neither agreement is in writing.

In September 1985 taxpayer engaged another person to manage the construction of the apartments. This amount was reimbursed by the partnership, and the taxpayer paid sales tax on it. Other amounts were reimbursed by the partnership to taxpayer, and retail sales tax was imposed on all such amounts. The taxpayer reported the fee under the service and other category of the business and occupation tax and paid that tax on it.

The auditor reclassified the fee from service to retailing and imposed retail sales tax. According to the auditor, the contract was a cost-plus fixed fee contract, and the measure of tax is the amount of the fee, plus all costs for which taxpayer was responsible. The auditor determined that the taxpayer's services were included within the definition of a retail sale as the constructing of new buildings for others and therefore taxable as a retail sale.

The taxpayer argues that substance should prevail over form, and that the only thing making this fee a retail sale is the fact that it is referred to in the construction contract as a "contractor's fee" rather than a "developer's fee." In the cost breakdowns submitted to the bank for the loan, the fee is referred to as a "developer's fee." Taxpayer also argues that its services are not within WAC 458-20-170, because the services were "feasibility studies, land acquisition, financial arrangements and assistance with plans" and such

services are not services within the rule. Taxpayer argues that the Board of Tax Appeals cases of Don Williams v. Department of Rev., Docket No. 4291 (1973) and Washington Water Power Co. v. Department of Rev., Docket No. 85-169, 1 WTD 377 (1986), hold that services performed prior to the time that a contract to perform construction services are entered into are taxable under the Service and Other category of the business and occupation tax and not as retail sales.

Taxpayer argues further that the services were 80% completed at the time that the written contract was entered into in September, 1985, and if any of the fee is taxable as a retail sale it is only that portion earned after the signing of the contract. Finally, taxpayer argues that if its fee is taxable as a retail sale then it is entitled to a credit for the amounts of retail sales tax it has previously paid, because "failure to credit these payments of Retail Sales Tax would result in taxing the items twice."

DISCUSSION:

RCW 82.04.050 defines a retail sale, in relevant part, as

> (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 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, and shall also include the sale of services or charges made for the clearing of land and the moving of earth excepting the mere leveling of land used in commercial farming or agriculture. . .
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> (g) the sale of or charge made for tangible personal property, labor and services to persons taxable under (a), (b), (c), (d), (e), and (f) above when such sales or charges are for property, labor and services which are used or consumed in whole or in part by such persons in the performance of any activity defined as a "sale at retail" or "retail sale" even though such property, labor and services

> may be resold after such use or consumption. Nothing contained in this paragraph shall be construed to modify the first paragraph of this section and nothing contained in the first paragraph of this section shall be construed to modify this paragraph.

WAC 458-20-170, the administrative rule implementing the statutes as regarding construction activities, provides as follows:

> The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing, repairing, decorating or improving of new or existing buildings or other structures under, upon or above real property, either for the entire work or for a specific portion thereof. . . The term "constructing, repairing, decorating or improving of new or existing buildings or other structures," in addition to its ordinary meaning, includes: . . . the 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.
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> (3)(a) Prime contractors are taxable under the retailing classification, and subcontractors under the wholesaling classification upon the gross contract price.

(Emphasis added.)

Under the rule and statute, services performed in respect to construction are taxable as a retail sale, whether or not they are actually included in the contract for construction. The Washington Supreme Court has adhered to this construction of the Rule; e.g., Chicago Bridge and Iron v. Department of Rev. 98 Wn. 2d 814 (1983), where it upheld the assessment of

Retailing business and occupation tax on contracts for design and fabrication, even though there was a separate contract for the installation. The court found that the separation of the design and manufacturing contracts from the installation contracts appeared to be "an exaltation of form over substance. . ." Id., at 822.

The Board of Tax Appeals cases cited by taxpayer both found that the amounts for services performed in respect to construction before a contract for construction was signed were taxable under the service category, rather than as retail sales. The Board stated, in Don Williams, that

> Rule 170 makes an exception to this general rule [that architects are taxable under the service category of the B&O tax] in holding that architectural fees are within the definition of the term "sales at retail" in cases where ". . . the services are included within a contract for the construction of a building or structure". The rule does not discuss or purport to cover services which, as in the present case, are not within a contract for construction. In the absence of any rule to the contrary, Rules 138 and 224 would appear to apply to this situation and these rules place architectural services within the service and not the retail sales classification. In summary, it appears to the Board that the position taken by the Department of Revenue in this case is in conflict with its own rules.
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> We hold that the architectural services of the appellant which were performed prior to the time that there was either a written or oral contract for the appellant to perform construction services are taxable under "Service and Other Activities" and not as retail sales. . . .

Don Williams, supra, at 4. (Emphasis in original.)

The Board went on to hold that the architectural services of the taxpayer that were performed prior to the time that there was either a "written or oral contract for the appellant to perform construction services" were taxable as services. Id, at 4.

In the Washington Water Power Co. case [WWPC], the Board followed its holding in Don Williams without comment.

[1] We believe that the Don Williams is distinguishable. The Board specifically found that there was neither an oral or written contract for construction before the contract was signed. In this case, there was an agreement, apparently oral, that the taxpayer would provide the construction services for the project from its inception. RCW 82.04.050 does not require that services be within a written contract for construction to be taxable as a retail sale; the statute requires only that the services be rendered in respect to construction in order to be considered a retail sale. Similarly, Rule 170 only requires that the services be performed in respect to construction; not that they be included in a written contract. The power of an administrative agency to make rules does not authorize it to write into the statute something that the legislature did not put there. Northern Pacific Railway Co. v. Henneford, 9 Wn.2d 18, 21 (1941). The reference, in Rule 170, to whether or not services are included in a written contract does not require that the services must be in it; it only means that simply bifurcating a contract into two parts will not change the tax consequences. Thus, whether or not certain services are within a written contract is not the factor that determines their tax consequences. If inclusion within a document was the decisive factor, then taxpayers could avoid the plain meaning of the statute by simply failing to enter into a written contract.

In this case, according to the affidavit first submitted by the managing partner of the buyer, taxpayer's duties were performing feasibility studies, arranging for the acquisition of extra land, financing of the purchase of the extra land and construction of improvements for the project and as well as helping the architect with the plans. The memorandum by the managing partner clearly indicates that the taxpayer is responsible for construction. These are clearly "services rendered in respect to" construction, and are clearly within the scope of the rule and statute. Taxpayer argues that the buyer was not required to hire it as the contractor on the project, but according to the affidavit, that was part of the original agreement. If taxpayer's argument is followed, then it agreed to be contractor for no remuneration, since it argues that it was entitled to the entire $170,000 fee before construction began, and it received no other payment, other than "reimbursements" for amounts that it paid to others.

Taxpayer argues that the Department is elevating form over substance, since if the fee had been designated in the contract as a "developer's fee" it would not be taxed as a retail sale. This is clearly not the case. Regardless of the label affixed to the fee, it was earned by the taxpayer for services in respect to construction and is therefore subject to the Retailing business and occupation tax and the retail sales tax.

[2] Finally, taxpayer argues that if the fee is found to be taxable, it should be allowed a credit for the retail sales tax it paid on other amounts it received from the buyer.

WAC 458-29-223 (Rule 223), provides that persons who perform contracts on a cost-plus fixed fee basis are subject to tax

> As to constructing and repairing of new or existing buildings, [under] WAC 458-20-170; . . .
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> The measure of the tax under each of the foregoing types of contracts is the amount of profit or fixed fee received, plus the amount of reimbursements or prepayments received on account of sales of materials and supplies, on account of labor costs, on account of taxes paid, on account of payments made to subcontractors, and on account of all other costs and expenses incurred by the contractor, plus all payments made by his principal directly to a creditor of the contractor in payment of a liability incurred by the latter.

Under this rule, taxpayer properly paid retail sales tax on the amounts it received from the buyer, and it is not entitled to credit such taxes paid against the tax due on the fee. There is no double taxation here.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 28th day of April 1989.