

Cite as Det. No. 15-0205, 35 WTD 202 (2016)

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. 15-0205
	)	
...	)	Registration No. . . .
	)	

[1] RULE 197; RCW 82.04.080: B&O TAX – ACCOUNTING METHODS – RECOGNITION OF INCOME – COMPLETED CONTRACT METHOD – SPECIAL APPLICATION – CONTRACTORS. Progress payments made to contractors are taxable at the time of receipt. Value accrues for a construction contractor using accrual basis accounting at the time the contractor becomes entitled to compensation under the contract.

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.

Sohng, A.L.J. – Home manufacturer protests instructions that it must report periodic payments when received, rather than when the contract is complete. The petition is denied.<sup>1</sup>

ISSUE

Under RCW 82.04.080 and WAC 458-20-197, must a manufacturer report periodic payments due under a sales contract when it receives such payments or when the contract is complete?

FINDINGS OF FACT

[Taxpayer] is a Washington corporation that manufactures and designs cedar homes. Taxpayer does not build the homes and is not a licensed contractor with the Washington Department of Labor & Industries. Taxpayer is an accrual basis monthly filer for purposes of Washington state excise taxes.

First, the customer pays Taxpayer a non-refundable deposit of \$ . . . to \$ . . . to draw up the blueprints for the home. Next, Taxpayer and the customer enter into a Sales & Earnest Money Agreement (the “Sales Agreement”), which requires the payment of a “Production Scheduling Deposit” when the contract is signed. The Production Scheduling Deposit is 35% of the total contract price, excluding sales tax, and secures the customer’s purchase order. The Sales Agreement also requires the customer to make the following additional “Balance Due

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

Payments”: (i) 60% of the remaining balance due must be paid five days before the first scheduled truckload ships; (ii) the remaining balance is due five days before the last scheduled truckload ships (if the particular job requires more than one truckload shipment). The time lapse between the first and second shipments is typically three to six weeks.

The following sample Sales Agreement illustrates the various payments required:

Special Requirements	Quoted price
Custom 34'x40'prow front cabin with half loft and 17'x23' wing using 5x8 cedar faced exterior timber walls and framed interior timber walls (cover by others), except (1) 4x8 cedar faced interior timber wall per IHC plans dated 3/9/2011. Detached 24'x26' garage, connected by breezeway, (2) vinyl windows, (3) vinyl sliding glass doors. (9) 6RP hemlock interior doors. Beam with T&G roof with 5½" rigid insulation. Remainder standard specifications.	\$ . . .
F.O.B. Factory Price	\$ . . .
Sales Tax 9%	\$ . . .
Total	\$ . . .
Less Plan Deposit	(\$ . . .)
Production Scheduling Deposit Due	\$ . . .
Balance Due (5 days prior to 1 <sup>st</sup> truck shipment)	\$ . . .
Balance Due (5 days prior to 2 <sup>nd</sup> truck shipment)	\$ . . .

Taxpayer reported all Balance Due Payments under the “contract completion method” provided in WAC 458-20-197 (i.e., when the customer makes the final Balance Due Payment). Taxpayer also reports under this method for federal tax purposes. For example, if the customer pays the first Balance Due payment on May 1, and the final Balance Due payment on June 1, Taxpayer reports both the first and second Balance Due Payments in June, when the contract is complete.

The Audit Division examined Taxpayer’s books and records for the period January 1, 2009 through June 30, 2012. On July 23, 2014, the Audit Division issued Assessment No. . . . , in the amount of \$ . . . , including \$ . . . in tax,<sup>2</sup> \$ . . . in interest, and \$ . . . in penalties. The Audit Division [instructed the Taxpayer to] report each Balance Due Payment in the month it is received, rather than at the end of the contract.

## ANALYSIS

The issue here is whether Taxpayer must recognize the Balance Due Payments when they are received or when the contract is complete. The gross income of a business is the “value proceeding or accruing,” as defined in RCW 82.04.090, by reason of the transaction of the business engaged in.<sup>3</sup> RCW 82.04.080. WAC 458-20-197 (“Rule 197”) is the Department’s administrative rule that governs the timing of when tax liability arises. Rule 197(1) provides:

<sup>2</sup> The majority of the tax consists of retail sales tax and retailing business and occupation tax.

<sup>3</sup> [RCW 82.04.090 reads, in part, as follows: “‘Value proceeding or accruing’ means the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued . . . .”]

Gross proceeds of sales and gross income shall be included in the excise tax return for the period in which the value proceeds or accrues to the taxpayer. For the purpose of determining tax liability of persons making sales of tangible personal property, a sale takes place when the goods sold are delivered to the buyer in this state.

(Emphasis added.) Thus, a seller's tax liability generally arises when tangible goods are delivered to the buyer. With respect to accrual basis taxpayers, however, Rule 197(2)(b) provides:

Amounts actually received do not constitute value accruing to the taxpayer in the period in which received if the value accrues to the taxpayer during another period. It is immaterial if the act or service for which the consideration accrues is performed or rendered, in whole or in part, during a period other than the one for which excise tax return is made. The controlling factor is the time when the taxpayer is entitled to receive, or takes credit for, the consideration.

(Emphasis added.) In short, Rule 197(2)(b) mandates that tax liability arises when the taxpayer is entitled to receive the consideration. Here, the Sales Agreement clearly entitles Taxpayer to the Balance Due Payments (i.e., the consideration) five days before each shipment. Therefore, Taxpayer must report the Balance Due Payments when received, not at the end of the contract. *See also* Det. No. 94-084, 14 WTD 240 (1995);

Taxpayer argues that it should be permitted to use the completed contract method, which is permitted under WAC 458-20-197(4)(b) . . . :

If by the terms of the contract the taxpayer becomes entitled to compensation only upon the completion of the work, value accrues as of the earlier of the completion of the work, or, any use of the facilities being constructed, or, 60 days after the facility is substantially complete.

However, Rule 197(4) expressly states that it is a special rule that applies only to contractors:

**(4) Special application, contractors.**

Value accrues for a building or construction contractor who maintains his accounting records on the accrual basis, as of the time the contractor becomes entitled to compensation under the contract.

(Emphasis in original.) Taxpayer is not a contractor, but rather, a manufacturer and seller of tangible personal property. Taxpayer does not have a contractor license with the Department of Labor & Industries. Therefore, Taxpayer may not rely on Rule 197(4) to report the Balance Due Payments at the end of each contract. Assuming, *arguendo*, that Taxpayer *was* a contractor, it would still be required to report the income when received because it would be "entitled to compensation under the contract" five days before each shipment, per the Sales Agreement. ["Rule 197(4) permits use of the completed contract method when the terms of a taxpayer's contract entitle it to compensation only upon completion of the work. The Sales Agreement contains no such provision."] Taxpayer's petition is denied.

DECISION AND DISPOSITION

We deny the petition.

Dated this 30th day of July, 2015.