

BEFORE THE INTERPRETATION AND 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. 88-224
)
)Registration No. . . .
)Document No. . . .
)Audit No. . . .

[1] **RULE 170:** RETAIL SALES TAX -- SPECULATIVE BUILDER -
- CUSTOM CONTRACTOR -- DISTINCTION. A speculative
builder is one who builds homes for sale or rent on
land it owns. A custom contractor is one who builds
homes for consumers on their land.

[2] **RULE 550 AND REAL ESTATE EXCISE TAX:** RETAIL SALES
TAX -- NOMINEE CUSTOM CONTRACTOR -- SPEC BUILDER. A
contractor who submits an affidavit under this rule,
to the effect that it takes the property as a
nominee for the buyer, is building custom homes and
is not a spec builder. The contractor who takes as
nominee is not the owner of the property; the buyer
is the owner of the property.

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 HEARING: April 7, 1988

NATURE OF ACTION:

The taxpayer petitions for correction of assessment to
reclassify construction from "custom" building to speculative
building.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- . . . (taxpayer) is a construction company building single and multifamily residences. Its records were audited for the period November 1, 1983, through June 30, 1987. The audit assessed additional taxes and interest owing in the amount of \$ The taxpayer protested the assessment.

During the relevant periods, the taxpayer reported all of its income as retailing and subject to the retail sales tax. The auditor determined that some of the taxpayer's construction activities were "speculative" construction activities, and certain were "custom" construction. The auditor credited the taxpayer for Retailing B&O and retail sales tax paid on those homes where the taxpayer was determined to have been acting as a speculative builder. She then assessed use tax on the materials (direct costs) for the "spec" houses, and calculated an income percentage figure to impose use tax on the indirect costs.

Sales tax was also assessed on unreported casual sales and capital assets, to which the taxpayer had no objections. Certain amounts which the taxpayer claims were for architectural fees only were included as "custom" and subjected to Retailing B&O and retail sales tax.

The taxpayer objects to the classification of many of the homes as "custom" rather than spec, arguing that it was the owner of the land on which the residences were built and that under Rule 170 the taxpayer's activities were that of a speculative builder.

Taxpayer states that a typical transaction takes place as follows:

Sept. 16, 1986 -- Prospective buyer (B) enters into contract with the taxpayer to purchase house to be constructed. It also signs an earnest money agreement with the taxpayer to purchase the lot on which the house is to be built. The contract states that:

(43) PURCHASERS agree not to occupy the house or place belongings therein until completed, final inspection by the City Building Department, and the Builder has been paid in full, including all

changes and additions, and Purchasers have inspected and accepted the completed house.

- (44) The closing date mentioned in paragraph 9, shall not be the date of transfer of title on the lot, but represents the Completion/Contract Expiration Date. The Completion/Contract Expiration Date shall be as follows: At such time as the Builder feels the dwelling is ready for a walk-through inspection, the Purchasers shall be notified. Purchasers and Builder shall schedule within 5 working days a walk-through inspection. Completion shall be defined as occurring when the dwelling has completed a walk-through satisfactory to Purchasers and faults, if any, have been corrected.

B is entitled to possession at the completion/contract expiration date, as described above. Under earnest money agreement, B is entitled to possession of the lot at closing.

The contract also provides as follows:

- (32) PURCHASERS shall pay for and secure interim construction financing. The interim construction loan shall have both the Purchasers and Builder as co-borrowers. The total Purchase Price referred to in paragraph 1 includes applicable Washington State Sales Tax and the cost of the Real Property (the lot, which will be purchased by the Builder and sold to the Purchasers by separate agreement of same date). The amount of the sales tax shall be itemized and supplied as a separate item upon completion of the house.

September 17, 1986 -- Once the contract is signed, the taxpayer signs an earnest money agreement with the Development Corporation to purchase the lot in question. Closing is to take place October 31, 1986.

October 9, 1986 -- The taxpayer obtains a 1 year construction loan, secured by a deed of trust and co-signed by B.

October 21, 1986 -- Development Corporation conveys the lot to the taxpayer by statutory warranty deed.

May 22, 1987 -- The taxpayer conveys lot and house to B by statutory warranty deed. No excise tax is paid on this transaction. According to the Real Estate Tax Affidavit, no real estate excise tax was paid because, although the deed does not note nominee status, the taxpayer (construction company) had actually taken the property as nominee for the ultimate buyer, and the buyer's money was used to purchase the land. Attached to the affidavit is a copy of the deed of trust and the deed from the developer/taxpayer, in which real estate excise tax was paid.

DISCUSSION:

[1] WAC 458-20-170 (Rule 170) explains the difference between speculative builders and prime contractors building homes for consumers. Under the rule, a prime contractor building "custom homes" is one who constructs buildings on real property for consumers. A speculative builder is one who constructs buildings for sale or rental on land it owns.

While it may be that there is some ambiguity in the contract as to whether the taxpayer's work is "speculative" or "custom" we find it unnecessary to decide that issue.

[2] Instead, we find that the statements made by the taxpayer in the real estate affidavit to transfer the property to the buyer without payment of the real estate excise tax control the issue. The taxpayer had to meet the requirements of WAC 458-61-550 (Rule 550), below, to avoid payment of the tax.

When a nominee has received title to or interest in real property on behalf of a third party principal, the real estate excise tax does not apply to the subsequent transfer of the property from the nominee to the third party, provided that:

- (1) The proper tax was paid on the initial transaction;
- (2) A notarized statement, as provided in WAC 458-61-150, is attached to the affidavit for the second transaction. Such notarized statement

must be dated on or prior to the first transaction;

- (3) The third party principal was in legal existence at the time of the initial transaction;
- (4) The funds used by the nominee to initially acquire the property were provided by the third party principal; and
- (5) The subsequent transfer from the nominee to the third party principal is not for a greater consideration than that of the initial acquisition.

The taxpayer submitted an affidavit to the effect that it was in fact taking the property for the buyer. Thus, the taxpayer was building a home on land owned by a consumer, the deed of trust had both the taxpayer and buyer's name as obligators, and the buyer paid for the land. Thus, the activity is "custom" building and the income was properly subject to the Retailing B&O and retail sales tax.

The taxpayer also objected to the inclusion of moneys received as architectural fees under Retailing B&O and retail sales tax. Monies received for architectural fees only is properly taxed under the Service and Other category and exempt from sales tax.

DECISION AND DISPOSITION:

The taxpayer's petition is denied in part and granted in part. The file will be returned to the Audit Section to confirm that the monies specified as architectural fees are in fact architectural fees. If so, they shall be reclassified under the tax category "Service and Other." The taxpayer's petition to have its activities classified as speculative building is denied. An amended assessment will be issued by the Department, to be due on the date specified thereon.

DATED this 27th day of May 1988.