

Cite as Det. No. 15-0259, 35 WTD 414 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) Assessment of)))) . . .))	<u>D E T E R M I N A T I O N</u> No. 15-0259 Registration No. . . .
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RULE 102; RCW 82.08.130: DEFERRED SALES TAX – TAX PAID AT SOURCE DEDUCTION – CONTRACTOR’S RIGHT TO CLAIM DEDUCTION. Only a construction contractor – as opposed to its customer – had a right to claim a tax paid at source deduction for sales tax paid on retail sales tax paid by the customer to subcontractors on behalf of the contractor because only the contractor was contractually liable to pay the subcontractors.

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.

Yonker, A.L.J. – An industrial engineering company (Taxpayer) protests the assessment of [deferred sales] tax on construction. . . . Taxpayer claims it should receive a credit for retail sales tax it previously paid to subcontractors for some of those materials and costs on behalf of the prime contractor. We remand Taxpayer’s petition.¹

ISSUE

Pursuant to Determination No. 01-077, 21 WTD 157 (2002), and RCW 82.08.020, is Taxpayer liable for [deferred sales] tax on construction, where Taxpayer paid retail sales tax to subcontractors for [some] materials [and costs] on behalf of the prime contractor?

FINDINGS OF FACT

[Taxpayer] is a Washington corporation that provides industrial design and engineering services, headquartered in . . . , Washington. Between 2010 and 2011, Taxpayer engaged [Contractor] to serve as prime contractor for a construction project at Taxpayer’s facility.² There was no written contract between Taxpayer and Contractor for the construction project.

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

² Taxpayer’s facility is actually owned by an affiliated company, which initially engaged Contractor. Part way through the construction project, Taxpayer became the responsible party in the agreement with Contractor.

During the course of the construction project, Taxpayer made three categories of payments on the construction project: (1) Taxpayer sometimes paid Contractor directly for work on the construction project, (2) subcontractors sometimes billed invoices directly to Taxpayer for materials and other construction expenses, and Taxpayer paid such invoices, and (3) subcontractors sometimes billed invoices to Contractor for materials for the construction project, and Contractor forwarded those invoices on to Taxpayer, who then paid such invoices even though the invoices were billed to Contractor. Only the third category of payments is relevant to this appeal.

In 2014, the Department's Audit Division conducted a review of Taxpayer's books and records for the period of January 1, 2009 through September 30, 2012. During that review, the Audit Division found that Contractor had not charged Taxpayer retail sales tax for any of the construction project. Since there was no written agreement between Taxpayer and Contractor, the Audit Division assessed [deferred sales] tax on the full amount of materials and other costs associated with the construction project, which, according to Taxpayer's records, was \$. . . ³ In addition, the Audit Division found that Taxpayer had paid \$. . . in retail sales tax to subcontractors on invoices billed to Contractor. The Audit Division did not allow any credit for the retail sales tax that Taxpayer paid in such cases because the Audit Division concluded that Contractor, and not Taxpayer, was primarily liable on those invoices.

On October 24, 2014, as a result of the Audit Division's review, the Department issued a tax assessment for \$. . . , which included \$. . . in use tax and/or deferred sales tax, a \$. . . five-percent assessment penalty, and \$. . . in interest.⁴ Taxpayer subsequently appealed \$. . . of the use tax and/or deferred sales tax that was assessed, which represents the amount of retail sales tax Taxpayer claimed it paid to subcontractors on invoices billed to Contractor.⁵ On January 21, 2015, Taxpayer paid all but \$. . . of the tax assessment.

On appeal, Taxpayer provided a copy of a letter dated May 5, 2015, signed by Contractor, which states the following:

The contract for the remodel project was "time and materials." I would submit my hours worked and the invoices from the suppliers and subcontractors to [Taxpayer] at the end of the month. In most cases, [Taxpayer] would pay the vendors directly for the materials plus sales tax and would pay me directly for my time.

I understand that [Taxpayer] has been audited by the Department of revenue and has not been given credit for the sales tax that was paid by them to the vendors.

³ This amount did not include instances where subcontractors billed invoices directly to Taxpayer (or the affiliated company) and also charged retail sales tax on such invoices. Such instances constitute the second category of payments discussed in the preceding paragraph.

⁴ The Department also issued a second tax assessment for \$. . . for various other audit findings that were not disputed by Taxpayer, which Taxpayer subsequently paid in full.

⁵ This figure is \$. . . more than the amount of retail sales tax that the Audit Division confirmed Taxpayer had paid to subcontractors on behalf of Contractor. This amount appears to be derived from a preliminary workpaper provided to Taxpayer prior to the tax assessment, and does not represent the final amount of retail sales tax that the Audit Division confirmed Taxpayer paid on invoices billed to Contractor.

If [Taxpayer] receives credit for the sales tax paid by them to the vendors, I will agree never to attempt to obtain a refund of sales tax from the vendors or the Department of Revenue relating to this project.

ANALYSIS

Taxpayer does not dispute that the construction services it received from Contractor constituted “retail sales” under RCW 82.04.050(2)(b) and, therefore, are generally subject to retail sales tax under RCW 82.08.020. There is also no dispute that Contractor did not collect retail sales tax on the construction services from Taxpayer Instead, Taxpayer argues that it paid retail sales tax previously on some of the construction materials that Contractor then incorporated into the construction project, and should receive a credit for those taxes it paid.

A taxpayer’s right to receive a credit or deduction for retail sales tax it paid at the source is found in RCW 82.08.130(2), which states the following:

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.

(Emphasis added). *See also* WAC 458-20-102(12) (Rule 102) (stating that the tax paid at source deduction or credit is available for a buyer who “subsequently resells a portion” of the property or services it purchased). The Audit Division concluded, and we agree, that those authorities are not applicable here because Taxpayer was not the “buyer” in the sales of materials at issue, nor did Taxpayer subsequently resell those materials, which RCW 82.08.130(2) and Rule 102(12) both require. Thus, even though there is no dispute that Taxpayer paid retail sales tax on the sales of materials at issue, Taxpayer is unable to receive credit for payment of such taxes under those authorities.

Instead, we conclude that only Contractor meets the requirements of RCW 82.08.130(2) and Rule 102(12), to claim a tax paid at source deduction for the retail sales tax paid on the sales of materials at issue because only Contractor was the named buyer on the invoices, and was, therefore, the obligated party to pay for those materials. We note, moreover, that under WAC 458-20-170(4)(c), “[s]ales to prime contractors . . . of materials . . . which become part of the structure being built or improved are sales for resale and are not subject to the retail sales tax.” Thus, the sales of materials to Contractor should not have been subject to retail sales tax in the first place under Rule 170(4)(c). Under WAC 450-20-229(4), Contractor may seek a refund or credit for retail sales tax paid in error. However, this right does not automatically flow to Taxpayer, who actually paid the retail sales tax. As such, the Audit Division properly disallowed Taxpayer’s claim for any deduction or credit for the retail sales tax it paid on the subcontractors’ sales of materials to Contractor.

Taxpayer directs our attention to our prior decision in Determination No. 01-077, 21 WTD 157 (2002), in support of its position that it should receive credit for the retail sales tax it paid on behalf of Contractor. In that decision, a land owner contracted with its wholly-owned construction company to complete certain improvements to the land. *Id.* at 158-59. Both the land owner and the wholly-owned construction company were audited and issued tax assessments. *Id.* at 158. Land owner had paid subcontractors directly for certain materials and services, including retail sales tax, even though the subcontractors had billed invoices to the wholly-owned construction company. *Id.* at 165. We noted in that determination that the materials and services at issue constituted “purchases” by the construction company for resale to the land owner and, thus, were sales at wholesale. *See id.* While we held that the subcontractor’s charge of retail sales tax and the land owner’s subsequent payment of such tax were done in error, we, nevertheless, concluded that the land owner was still entitled to a credit for the erroneously-paid retail sales tax to the subcontractors. *Id.* at 166. We ordered the case to be “remanded to the Audit Division to exclude from the deferred sales/use tax assessment against [Land Owner] erroneously paid on invoices to [Construction Company] for labor and materials used in constructing the buildings for sale to [Land Owner].” *Id.* (Brackets in original).

While we ultimately allowed the land owner a credit in that case for the retail sales tax it paid on behalf of its wholly-owned construction company, that credit was not based on the land owner qualifying for a credit under RCW 82.08.130(2) or Rule 102(12). Instead it was based on the fact that the retail sales tax was “erroneously paid” to begin with. *Id.* Specifically, we stated that “retail sales tax was not due on the invoices for materials and labor because the purchases were for resale from [Construction Company] to [Land Owner].” *Id.* at 165 (Brackets in original). Because the construction company was the obligated party on the invoices that erroneously included retail sales tax, it was the construction company – not the land owner – that was entitled to a refund or credit for the retail sales tax actually paid in those instances. *See id.* at 166, note 5. However, given the fact that in that case that the land owner actually owned the construction company, we imputed the construction company’s right to receive a refund or credit to the land owner for the retail sales tax erroneously paid.

Here, the facts are not the same as those in 21 WTD 157. There is no common ownership between Contractor, the obligated party on the invoices at issue, and Taxpayer, the party that actually paid the invoices. As such, we are unable to automatically impute Contractor’s right to refund or credit to Taxpayer for the retail sales tax erroneously paid on the invoices.

We note, however, that Taxpayer has provided a statement from Contractor in which he promises to not seek refund for the retail sales tax paid on the invoices issued to it should Taxpayer receive a credit for such taxes. We interpret this statement as an attempt by Contractor to assign its right to a refund or credit under Rule 229, discussed earlier, for the retail sales tax erroneously paid.

We previously have addressed the issue of a taxpayer’s assignment of the right to a refund or credit in Determination No. 07-0324E, 27 WTD 119 (2008). There, a contractor had collected retail sales tax from its customer on certain equipment which the customer and contractor later discovered was exempt from retail sales tax. *Id.* at 121. The contractor and customer had agreed by written contract that any refund granted by the Department would “accrue solely to the

benefit of Contractor.” *Id.* Based on that agreement, the contractor sought refund of the retail sales tax the customer paid on the exempt equipment. *Id.* We reasoned as follows:

We first note that the Department of Revenue was not a party to the contract between Contactor and [the purchaser]. In addition, Rule 229(3)(b)(ii) does not directly address the situations where the taxpayer and the seller agree that any refund is to accrue to the benefit of the seller. However, even though Rule 229(3)(b)(ii) does not contemplate the exact circumstance presented in this appeal, we conclude that Contractor has met the “refund to taxpayer” requirement of Rule 229(3)(b)(ii) by virtue of obtaining a written release from the taxpayer ([the purchaser]) affirming that any refund belongs to Contractor. By agreeing to the release, [the purchaser] has essentially assigned its right to claim the refund to the Contractor. It is generally understood in Washington that the right to claim a sales tax refund can be assigned. *See Puget Sound National Bank v. State, Department of Rev.*, 123 Wn.2d 284, 868 P.2d 127 (1994) (absent an express statutory provision to the contrary, a claim for tax refund is assignable). As the assignee of [the purchaser’s] right to claim a refund of sales tax erroneously paid, Contractor “steps into the shoes of the assignor, and has all the rights of the assignor.” *Id.* at 292, 868 P.2d at 132 (quoting *Estate of Jordan v. Hartford Accident & Indem. Co.*, 120 Wn.2d 490, 495, 844 P.2d 403(1993)).

Id. at 123-24.

We conclude that the same reasoning may apply here. So long as there is no statutory bar to assignment of a right to refund or credit, Contractor here may assign its right to a refund or credit for the amount of retail sales tax paid on the materials in the invoices at issue. We have found no such statutory bar. Contactor has signed a letter stating, in pertinent part, that “[i]f [Taxpayer] receives credit for the sales tax paid by them to the vendors, I will agree never to attempt to obtain a refund of sales tax from the vendors or the Department of Revenue relating to this project.” While this language appears to suggest an assignment of Contractor’s right to refund or credit under Rule 229, it does not expressly assign that right. Nevertheless, given the language of that letter, we remand this appeal back to the Audit Division to allow Taxpayer thirty days to submit a written agreement in which Contractor expressly assigns his right to refund of retail sales tax paid on invoices for materials associated with the construction project.

We also note that Taxpayer has claimed an amount of \$. . . in retail sales tax paid compared with the slightly different amount of \$. . . in retail sales tax paid that was confirmed by the Audit Division during the review process. Taxpayer will have thirty days to also provide documentation supporting its claimed amount.

DECISION AND DISPOSITION

We are remanding the case to Audit Division (Operating Division) for possible adjustment to the assessment

Dated this 23rd day of September, 2015.