

In the Matter of the Petition )	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment )	
of )	No. 90-366
)	
. . . )	Registration No. . . .
)	. . ./Audit No. . . .
)	

The Department of Revenue ([Department]) examined the taxpayer's business records for the period from . . . through . . . . As a

result of this audit, the Department issued the above captioned tax assessment on . . . asserting excise tax liability in the amount of \$ . . . and interest due in the amount of \$ . . . for a total sum due of \$ . . . . The taxpayer made a payment of \$ . . . on . . . and the balance remains due.

The taxpayer's protest involves Schedule II where Retailing business and occupation (B&O) tax and retail sales tax liability were assessed on fees for architectural services performed in connection with the design and construction work done by the taxpayer. The sale of the architectural services took place in 1984 and 1985, and were subjected to Retailing B&O tax and sales tax liability in a prior audit for the period from . . . through . . . . At a supervisor's conference held on . . . , the taxpayer was instructed that where the taxpayer contracts to design and construct projects by separate contracts respectively, the amounts involved from both contracts are subject to Retailing B&O tax and sales tax. At that time, the taxpayer had relied on its interpretation of a contractor's manual that if architectural fees were pursuant to a separate contract they would be considered a service taxable under the tax classification of Service B&O. The taxpayer then indicated at that time that it would cancel the separate contract for architectural services and have a related entity, . . . , bill the customer for the services. The taxpayer was then advised that an after the fact change would not be acceptable to negate the tax liability.

In the October 1986 excise tax return, the taxpayer reduced the amount reported as subject to Retailing B&O by the amount of the architectural fees subjected to Retailing B&O in the prior audit. Schedule II of the current audit assesses tax on the amounts deducted and unreported.

The taxpayer claims that at the . . . supervisor's conference it was informed that if it billed separately for the architectural services it would not be subject to the sales tax, and so it followed the above procedure of having the related entity, . . . , billing the customer for the architectural services after the taxpayer's granting of a credit to the customer in the same amount. The related entity did not include the fees in its taxable income.

The taxpayer asserts that the architectural fees are for professional services and are not taxable under the sales tax statute, RCW 82.02.020, or under the regulation dealing with construction, WAC 458-20-170 (Rule 170). Rather, the taxpayer asserts that the fees are subject to the Service B&O tax under RCW 82.04 and WAC 458-20-224 (Rule 224).

The issue is whether architectural fees earned from the taxpayer's separate contract but related to the taxpayer's separate contract for construction are subject to Service B&O tax or to Retailing B&O tax and sales tax consequences. Another issue is whether the taxpayer can avoid the Retailing B&O tax and sales tax consequences

by having a related corporation substitute for the taxpayer by billing the customer separately for the architectural fees after the taxpayer has performed the architectural work.

#### DISCUSSION:

RCW 82.08.020 imposes the retail sales tax on each retail sale in this state. RCW 82.04.050(2)(b) defines a "retail sale" in pertinent part as:

...the constructing, repairing, decorating or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers.

[1] Rule 170 implements the statute and is the relevant regulation applying to the taxpayer's income from architectural services. Rule 170 in pertinent part provides:

(1) DEFINITIONS. As used herein:

- (a) The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing...of new or existing buildings or other structures under, upon or above real property, either the entire work or for a specific portion thereof....
- (b) The term "subcontractor" means a person engaged in the business of performing a similar service for persons other than consumers, either for the entire work or for a specific portion thereof....

...

- (e) The term "constructing...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.

...

## (3) BUSINESS AND OCCUPATION TAX.

- (a) Prime contractors are taxable under the retailing classification, and subcontractors under the wholesaling classification upon the gross contract price.

...

## (4) RETAIL SALES TAX.

- (a) Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. (Emphasis supplied.)

Clearly, the income received for performing architectural services is subject to Retailing B&O tax and retail sales tax if the person performing those services is also performing construction services as well as architectural services on the same project or if those services are included within a construction contract.

In this case, the taxpayer contracted as a prime contractor to perform both architectural services and construction services with respect to the same project. The fact that the services were contracted for by separate contracts does not change the nature of the architectural services, that is, they were still "rendered in respect" to construction by the taxpayer as a prime contractor. Accordingly, the fees for architectural services are subject to Retailing B&O tax and retail sales tax. Rule 170.

The taxpayer has cited Rule 224 for support of its claim that the architectural services are taxable under the tax classification of Service B&O. However, that is valid only when pure architectural services, that is, design work only, are rendered; not when the services are "rendered in respect" to construction pursuant to a contemporaneous construction contract or rendered contemporaneously at the construction site. Rule 170.

The taxpayer's subterfuge of having a related entity billing the customer separately for the architectural services cannot be accepted. RCW 82.32.050 in pertinent part provides:

If the department finds that all or any part of the deficiency resulted from an intent to evade the tax payable hereunder, a further penalty of fifty percent of the additional tax found to be due shall be added.

In this case, the auditor concluded that the taxpayer was attempting to reduce its tax liability by restructuring its arrangement with its customers so that its related entity billed for the architectural services rendered by the taxpayer. It is noted that the taxpayer reported that the related entity never reported the income for tax purposes although the taxpayer deducted

compensating amounts from its total reported gross receipts. Clearly, it appears that the taxpayer is fortunate that the fifty percent evasion penalty was not assessed based upon the circumstances involved.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 24th day of October, 1990.