Cite as Det. No. 01-140, 22 WTD 26 (2003)

BEFORE THE 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. 01-140[1]
	)	
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

[1] RULE 170; RCW 82.04.051: RETAIL SALES TAX – CONSTRUCTION MANAGEMENT SERVICES – "SERVICES RENDERED IN RESPECT TO CONSTRUCTION." To be rendered in respect to construction activities, the services themselves must "directly relate to the constructing" and the provider of the services must be responsible for "the preformance of the constructing."

[2] RCW 82.04.220: B&O TAX -- GROSS INCOME OF THE BUSINESS – PARTNERSHIP DISTRIBUTION. Partners need not pay tax on payments received from the partnership as distribution of contributions or profits. Payments partners receive for providing services are subject to tax. Det. No. 90-74, 9 WTD 143 (1993).

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.

NATURE OF ACTION:

Taxpayer/general partner requests cancellation of retailing B&O tax and retail sales tax assessed on funds it received from the partnership, maintaining the payments were nontaxable partnership distributions.[2]

[1] Det. No. 01-140R is published at 22 WTD 37 (2003).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

Lewis, A.L.J. -- Taxpayer is the general partner in a Limited Partnership, [LP]. The limited partnership was formed with the sole purpose of building a . . . single family development in . . . , Washington. The Department of Revenue's ("Department") Audit Division ("Audit") audited Taxpayer's books and records for the period May 13, 1996 through September 30, 1999. On October 10, 2000, the Department issued a $ . . . tax assessment.[3] Most of the tax resulted from the assessment of retailing business and occupation ("B&O") and retail sales tax on payments received from [LP]. Audit maintained the payments received from [LP] were received as fees for providing construction management. The audit report narrative stated:

> This schedule asserts retailing and retail sales tax on amounts received from [LP] for construction management fees. These fees included reimbursement for construction salaries, construction superintendent salary, and construction supplies. These amounts were credited to expense accounts. The fees also included a charge representing 3% of gross sales price of a house. This charge was to cover administration costs. These amounts were recorded in the general ledger as management fees.
>
> The amounts asserted in this schedule do not include other third party payments for materials, subcontractor services, and other costs. These amounts were billed directly to [LP], and the amounts were paid out by the [LP] bank account. Neither do they include amounts received as capital contributions distributions or expenses, such as co-op advertising, that were not related to construction activities.

Taxpayer disagreed. On January 5, 2001, Taxpayer filed a petition requesting correction of the audit assessment. Taxpayer argued that the amounts it received from [LP] represented distributions from the limited partnership. Taxpayer maintained that as a partner, it was entitled to receive payments from the partnership representing distributions of profits.

To determine Taxpayer's role as general partner, Audit requested a copy of the partnership agreement. After delays, Taxpayer supplied Audit with a "redlined" copy of the restated agreement.[4] Taxpayer maintained that the partners restated the Agreement to better reflect the Taxpayer's role.

The redlined Agreement showed what was deleted in the old agreement and restated in the new Agreement. The audit report listed some of the differences between the old and restated Agreement.

1. **Article 2.1 General Partner's Contributions (Pages 10-12)** – The restated agreement states that the General Partner's services and labor will be considered as contributions to the General Partner's Invested Capital account. The old agreement

[3] $ . . . tax, $ . . . interest, and $ . . . penalty.
[4] The "redlined" copy of the agreement contains both the text of the original Agreement and the changes.

only stated that the General Partner may be entitled to receive credit for additional capital contributions relating to the "Supplemental Overhead allowance."

2. **Article 4.2 Powers of General Partner (Page 24)** – The restated agreement gives the General Partner powers to "supervise all planning, personnel, financial aspects and other Partnership business in connection with the Project, Lots and Units." The old agreement gives the General Partner powers to "supervise all planning, engineering, and development of the Project, to supervise development of the Lots and construction of the Units."

3. **Article 4.4.1 Management Duties (Pages 26-27)** – The restated agreement states that the General Partner shall not be a construction manager for the partnership. The old agreement states that the General Partner shall be responsible for management of activities, such as permit processing, development, and construction.[5]

4. **Article 4.5 Compensation to General Partner (Pages 27-31)** – The restated agreement eliminates most of this article. The amounts designated as compensation in the old agreement are now stated in contributions in Article 2.1. The old agreement states that the General Partner will receive compensation for the services, materials, and facilities to be provided. The restated agreement discusses compensation for project personnel and other compensation only.[6]

5. **Article 9 Profits and Losses (Pages 49-51)** – Profits and loses are determined after amounts are paid to the General Partner. The restated agreement calls these amounts "LP Unmatched Capital Return" and the old agreement includes allowances and fees to be paid to the General Partner.

[5] Section 4.4.1 of the old Agreement stated:

> The General Partner shall be responsible for overall executive management of the acquisition, planning, permit processing, development, construction, and sale of the Project, including but not limited to the following . . . .

[6] Section 4.5.1 of the old Agreement stated:

> As its sole compensation for the services, materials and facilities to be provided pursuant to Section 4.4.2, the General Partner shall be paid by the Partnership a base overhead and administrative allowance up to an aggregate amount of $ . . . (the "Base Overhead Allowance"), and if and only if certain conditions are satisfied, the General Partner shall also be entitled to receive a supplemental overhead and administrative allowance, which is in addition to the Base Overhead Allowance, up to an aggregate amount of $ . . . (the "Supplemental Overhead Allowance"). Except as provided in Section 4.5.1.3 (provisions relating to a default by the General Partner), the Base Overhead Allowance shall be earned and paid as provided in Section 4.5.1.1. The conditions under which the Supplemental Overhead Allowance may be earned, and the timing and method of payment of the Supplemental Overhead allowance (except as provided in Section 4.5.1.3 if the General Partner is in default), are set forth in Section 4.5.1.2.

6. **Article 10.2 Distribution Priority (page 52)** – The restated agreement deletes the priority given in the old agreement to pay the General Partner overhead and administrative allowance.[7]

Audit's response to the restated Agreement was:

> The restated agreement purports to show that the General Partner is not receiving compensation for its services. However, the old agreement and the accounting records clearly do show that you were receiving gross income from construction management services. It is self-serving to change the agreement and make it retroactive to avoid the tax consequences of being a construction manager.

Although the state had issued Taxpayer a Unified Business Identification number ("UBI'), Taxpayer was not registered with the Department of Revenue. Because Taxpayer had not filed state excise tax returns and paid no tax a mandatory 20% late-payment penalty was added to the assessment. Taxpayer's petition argues that the late-payment penalty should be cancelled because Taxpayer had a good faith belief that it owned no tax and thus no obligation to register with the Department.

ISSUES:

1. Whether Taxpayer provided the partnership with services rendered "in respect to construction"?

2. Whether the payments received from rendered services "in respect to construction," if so provided by Taxpayer, would require payment of retailing B&O and retail sales tax by Taxpayer?

3. Whether the Department correctly added a 20% late-payment penalty to Taxpayer's assessment?

4. Whether the Department can cancel the 20% late-payment penalty?

DISCUSSION:

[7] Section 10.2 of the old Agreement stated:

> Cash assets available to the Partnership shall be applied first to pay any and all obligations then due and owing to third parties and/or to Partners (including but not limited to the LP Unmatched Capital Return, if any, General Partner overhead and administrative allowance, and Limited Partner loans to the Partnership and General Partner loans to the Partnership (concurrently), in that order of priority), and then to maintain Working Capital. Thereafter, any Cash Available for Distribution to the Partners shall be allocated and distributed as follows (except upon liquidation of the Partnership, when Cash Available for Distribution shall be allocated and distributed in accordance with section 11.6) . . . .

[1] The term "sale at retail" as defined by RCW 82.04.050(2) expressly includes "services rendered in respect to . . .constructing":

> [T]he sale of or charge made for tangible personal property consumed and/or for labor or 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, . . .

(Emphasis added.)

In 1999, the legislature issued clarifying legislation of what constitutes services rendered in respect to constructing, building, repairing etc. Chapter 212, Laws of 1999 (HB 2261) became effective on July 25, 1999, and was subsequently enacted as RCW 82.04.051. The introduction to HB2261 specifically addresses the need for clarification on services rendered in respect to construction and states:

> NEW SECTION. Sec. 1. (1) The legislature finds that the taxation of "services rendered in respect to constructing buildings or other structures" has generally included the entire transaction for construction, including certain services provided directly to the consumer or owner rather than the person engaged in the performance of the constructing activity. Changes in business practices and recent administrative and court decisions have confused the issue. It is the intent of the legislature to clarify which services, if standing alone and not part of the construction agreement, are taxed as retail or wholesale sales, and which services will continue to be taxed as a service.
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> (2) It is further the intent of the legislature to confirm that the entire price for the construction of a building or other structure for a consumer or owner continues to be a retail sale, even though some of the individual services reflected in the price, if provided alone, would be taxed as services and not as separate retail or wholesale sales.
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> (3) Therefore, the intent of this act is to maintain the application of the law and not to extend retail treatment to activities not previously treated as retail activities. Services that are otherwise subject to tax as a service under RCW 82.04.290(2), including but not limited to engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services, remain subject to tax as a service under RCW 82.04.290(2), if the person responsible for the performance of those services is not also responsible for the performance of the constructing, building, repairing, improving, or decorating activities. Additionally, unless otherwise provided by law, a person entering into an agreement to be responsible for the performance of services otherwise subject to tax as a service under RCW 82.04.290(2), and subsequently entering into a separate agreement to be responsible for the performance of constructing, building, repairing, improving, or decorating activities, is subject to tax as a service under RCW 82.04.290(2) with respect to the first agreement, and is subject to tax under the appropriate section of

> chapter 82.04 RCW with respect to the second agreement, if at the time of the first agreement there was no contemplation by the parties, as evidenced by the facts, that the agreements would be awarded to the same person.

Because RCW 82.04.051 is a clarifying statute and not an amendatory statute, it has retroactive application. *Marine Power and Equip. Co. v. Human Rts. Comm. Hearing Tribunal*, 39 Wn.App. 609, 614, 694 P.2d 697 (1985). Therefore, the standards articulated in this legislation apply to this appeal even though the activities in dispute took place before its effective date.

RCW 82.04.051 provides a definition for determining when a construction service are considered a retail service. This clarifying statute provides:

> (1) As used in RCW 82.04.050, the term "services rendered in respect to" means those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. The term does not include services such as engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services provided to the consumer of, or person responsible for performing, the constructing, building, repairing, improving, or decorating services.

(Emphasis added.)

The new statutory language provides for consideration of both the nature of the services provided and the entity providing them in characterizing the services for tax purposes. To be rendered in respect to construction activities the services themselves must "directly relate to the constructing" and the provider of the services must be responsible for "the performance of the constructing."

Section 4.4.1 of the Partnership Agreement lists Taxpayer's management duties. It states:

> The General Partner shall be responsible for overall executive management of the acquisition, planning, permit processing, development, construction, and sale of the Project, including but not limited to the following:
>
> 4.4.1.1 Working with, coordinating and supervising architects, engineers, and other in the design, planning and development of the Project;
>
> 4.4.1.2 Providing all in-house engineering, planning and design for the Project that is not contracted to outside consultants;
>
> 4.4.1.3 Preparing and processing of applications for licenses, building permits, and other governmental approvals, and of applications and agreements for utility installation and services;

> 4.4.1.5 Estimating and purchasing of materials not to be provided under construction contracts;
>
> 4.4.1.6 Budgeting and bookkeeping for all expenditures and disbursements related to the Project and the Partnership, including all accounting for and the preparation of all periodic financial statements and reports required under this Agreement (other than the periodic auditing of such financial statements by independent certified public accountants);
>
> 4.4.1.7 Supervising the in-house marketing analysis, marketing and sale of the Project, including retaining and managing sales agents and brokers; and
>
> 4.4.1.8 Financing of the Project, including determining the need of the Partnership for additional capital, administering the Partnership's obligations under the Property Acquisition Agreement and the Land Loan, the Acquisition and Development Loan, the Construction Loan, the Future Land Loan (if obtained), and the Future A&D Loan (if obtained), and investigating, applying for, obtaining and administering the Partnership's obligations under any other loan or financing authorized herein.

We are not persuaded that Taxpayer's restatement of the Partnership Agreement accurately reflects Taxpayer's role in the construction of the residential development. Rather, we find the original Partnership Agreement most reflective of the relationship. It appears from the timing of the restatement of the agreement and the changes made that it was done primarily for state excise tax purposes. The audit report narrative supports such a conclusion. According to the audit report's narrative, Audit requested a copy of the partnership agreement at a supervisor's conference:

> We asked for a copy of the limited partnership agreement. [Representative] told us that the old agreement was being restated and had not been signed by the parties [at] our conference. He said that the agreement was being restated to be in conformance with a recent unsanitized determination he had received from the Department of Revenue.

A comparison of the two partnership agreements shows substantial changes in the documents. The original document provides that Taxpayer's services not only directly relate to the construction activity, but that Taxpayer was responsible for "the performance of the constructing." For example:

Article 4.2 Powers of General Partner (Page 24) – The restated agreement gives the General Partner powers to "supervise all planning, personnel, financial aspects and other Partnership business in connection with the Project, Lots and Units." Whereas, the old agreement gives the General Partner powers to "supervise all planning, engineering, and development of the Project, to supervise development of the Lots and construction of the Units."

Article 4.4.1 Management Duties (Pages 26-27) – The restated agreement states that the General Partner shall not be a construction manager for the partnership. Whereas, the old agreement states that the General Partner shall be responsible for management of activities, such as permit processing, development, and construction.[8]

Having found that Taxpayer provides services in respect to construction our next inquiry is whether Taxpayer, as a general partner, must pay retailing B&O and retail sales tax on the payments it received.

[2] Previously, the Department addressed the issue of whether a partner must pay tax on the payments it receives for services it renders to the partnership. Under Washington tax law, partners need not pay tax on payments received from the partnership as a distribution profits . . . that is on payments received not related to providing services. However, payments the partner received for providing services may be subject to tax. Det. No. 90-74, 9 WTD 143 (1990), summarized the Department's position stating:

> . . . partners are considered as third party service providers to the partnership of which they are a member when the obligation of the partnership to pay for such services is "absolute" or fixed, and exists independently of any right to profit or gain. Where a partner has no right to any payment unless some profit or gain exists, the payment is not absolute and therefore not subject to tax.

Thus, Det. No. 90-74 held that the partner was liable for retailing business and occupation ("B&O") tax and retail sales taxes when it has a right to payment which existed independently of its right to share profits. Det. No 90-74 stated:

> When it [partner] is itself receiving payment for services it has provided, it is acting in the same capacity as any other service provider and is taxable on that income.

By contrast, Det. No. 90-74 also stated that the partner was not liable for taxes on income paid to the other contractors:

> . . . when taxpayer is paying third party vendors for services rendered to the partnership, the taxpayer is acting as a partner and not as a prime contractor, and the money is not attributable to it.

In this case, the original Partnership Agreement made clear that Taxpayer received a guaranteed payment for providing services:

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[8] Section 4.4.1 of the old Agreement stated:

> The General Partner shall be responsible for overall executive management of the acquisition, planning, permit processing, development, construction, and sale of the Project, including but not limited to the following . . . .

> 4.5 Compensation to General Partner.
>
> 4.5.1 Overhead and Administrative Allowance. As its sole compensation for the services, materials and facilities to be provided pursuant to Section 4.4.2, the General Partner shall be paid by the Partnership a base overhead and administrative allowance up to an aggregate of $ . . . (the "Base Overhead Allowance'), and if and only if certain conditions are satisfied, the General Partner shall also be entitled to receive a supplemental overhead and administrative allowance, which is in addition to the Base Overhead Allowance, up to an aggregate amount of $ . . . (the "Supplemental Overhead Allowance"). Except as provided in Section 4.5.1.3 (provisions relating to a default by the General Partner), the Base Overhead Allowance shall be earned and paid as provided in Section 4.5.1.1. The conditions under which the Supplemental Overhead Allowance may be earned, and the timing and method of payment of the Supplemental Overhead Allowance (except as provided in Section 4.5.1.3 if the General Partner is in default), are set forth in Section 4.5.1.2.
>
> The amounts of the Base Overhead Allowance and the Supplemental Overhead Allowance shall be adjusted proportionately if the final number of Units changes.

By the terms of the original Partnership Agreement, the funds Taxpayer received were guaranteed payments for services provided and not partnership distributions. of profit. Taxpayer accounted for the monies received consistent with our conclusion. According to the audit report the reimbursements Taxpayer received for construction salaries, construction superintendent salary and construction supplies were credited to expense accounts. The amounts Taxpayer received as administrative expense was recorded in Taxpayer's general ledger as a management fee. In addition, Taxpayer reported the monies received as income and not partnership distributions. Accordingly, we sustain the tax assessment finding Taxpayer received taxable income for providing services in respect to construction.

Finally, Taxpayer appealed the 20% late-payment penalty added to the assessment. RCW 82.32A.030 provides in pertinent part:

> To ensure consistent application of the revenue laws, taxpayers have certain responsibilities under chapter 82.32 RCW, including, but not limited to, the responsibility to:
>
> (1) Register with the department of revenue;
>
> (2) Know their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue;

It is each individual's responsibility to be aware of any tax implications resulting from activities conducted within this state. Department of Revenue personnel are available to answer any inquiries pertaining to such matters and information is readily available. The taxes imposed by the Revenue Act are of a self-assessing nature and the burden is placed upon a person to correctly inform himself of his obligations under the Act. RCW 82.32A.030.

Thus, Taxpayer should have registered with the Department and filed regular excise tax returns thereafter. Had this happened, Taxpayer would have avoided the imposition of late-payment penalties.

RCW 82.32.090 makes mandatory the assessment of late-payment penalties upon delinquent payment of taxes.

RCW 82.32.090 provides in pertinent part:

> If payment of any tax due is not received by the department of revenue by the due date, there shall be assessed a penalty of five percent of the amount of the tax; and if the tax is not received within thirty days after the due date, there shall be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within sixty days after the due date, there shall be assessed a total penalty of twenty percent of the amount of the tax. . . .

(Emphasis supplied.)

In this case, Taxpayer was not registered with the Department and had not made any payment of taxes. The assessment billed Taxpayer for taxes more than sixty days delinquent. Accordingly, the statutory (RCW 82.32.090) late-payment penalty of twenty percent applied.

The legislature, through its use of the word "shall" in RCW 82.32.090, has made the assessment of the penalty mandatory. The mere fact of nonpayment within a specified period of payment requires the penalty provisions of RCW 82.32.090 to be applied.

As an administrative agency the Department of Revenue is given no discretionary authority to waive or cancel penalties. The only authority to waive or cancel penalties is found in RCW 82.32.105 which in pertinent part provides:

> If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any interest or penalties imposed under this chapter with respect to such tax. The department of revenue shall prescribe rules for the waiver or cancellation of interest or penalties imposed by this chapter. (Emphasis supplied.)

Administrative Rule WAC 458-20-228(6) (Rule 228) implements the statute and specifically states:

> The department will waive or cancel the penalties imposed under RCW 82.32.090 and interest imposed under RCW 82.32.050 upon finding that the failure of a taxpayer to pay any tax by the due date was due to circumstances beyond the control of the taxpayer. The department has no authority to cancel penalties or interest for any other reason. Penalties

> will not be cancelled merely because of ignorance or a lack of knowledge by the taxpayer of the tax liability.

(Emphasis added.)

It is unfortunate that Taxpayer believed it need not register with the Department because it owed no tax. However, Taxpayer's mistaken belief based on a lack of knowledge is not a circumstance that allows for cancellation of penalty. For the reasons stated we conclude that the assessed twenty percent late payment penalty was proper and cannot be waived.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 26th day of September 2001.