

Cite as Det. No. 15-0135, 35 WTD 135 (2016)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund ) D E T E R M I N A T I O N  
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   No. 15-0135  
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   Registration No. . . .  
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RULE 170; RCW 82.04.050: RETAIL SALES TAX – RETAILING B&O TAX – SERVICES IN RESPECT TO CONSTRUCTING –ARCHITECTURAL SERVICES. In addition to services that involve the actual physical construction of buildings and structures, services in respect to such constructing activity are subject to retail sales tax and retailing B&O tax. When it is contemplated from the outset of the project that the design and construction work would be provided by the same person the design services were properly reclassified as a retail service.

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.

Kreger, A.L.J. – A firm providing both architectural design and construction services protests reclassification of design work from the service and other business and occupation (B&O) classification to the retailing business B&O and retail sales tax classifications on projects where it also acted as contractor. Because there is evidence that the parties contemplated that the Taxpayer would provide both services, we affirm the classification of the design work as a retail service. The Taxpayer's petition is denied.<sup>1</sup>

ISSUE

Whether design work provided by the company that also provided the construction services are services rendered in respect to construction under RCW 82.04.051 and WAC 458-20-170 and subject to retail sales tax and retailing B&O tax?

FINDINGS OF FACT

[The Taxpayer] is a Washington corporation engaged in the business of providing architectural design and construction services. The Taxpayer provides architectural design services for both commercial and residential projects, and also provides a full range of construction services from remodels to commercial construction. The majority of the Taxpayer's work relates to residential

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

construction projects. The Taxpayer estimates that approximately half of its work is design work and half construction work, but noted that the architectural work was the focus of the firm and was something that differentiated them from other design/build construction companies.

The Department of Revenue's (Department's) Audit Division (Audit) audited the Taxpayer's Washington business activities for the period of January 1, 2010 through June 30, 2013. The audit identified several tax deficiencies which resulted in two assessments being issued at the conclusion of the audit. The first assessment was not contested and addressed retailing B&O and retail sales tax deficiencies identified through a reconciliation of the amounts reported on the Taxpayer's excise tax returns and the amounts recorded in the Taxpayer's books and records. The second assessment, Document No. . . . in the amount of \$ . . . assessed retailing B&O and retail sales tax, and provided a credit for service B&O tax for design work on projects where the Taxpayer subsequently also provided construction services.<sup>2</sup> The Taxpayer timely paid the assessment in full and filed an appeal seeking a refund of the tax at issue asserting that the design work at issue was properly reported.

Audit reclassified the projects at issue based on language in the design contracts that states "It is anticipated that [Taxpayer] will also handle the construction phase of the project if the client so wishes and agreements and documents shall be provided to address that phase in due course." Audit also noted, for the projects at issue, that the construction contracts were entered into shortly after the design work was complete, generally within 6 months or less.

The Taxpayer characterized the language in the design contract as conveying an option and notes that the customers are not obligated to hire them for the construction work. The Taxpayer also noted that it is not unusual for a client to hire them just for design work and that no decision regarding construction work is made at the time that the design contract is negotiated. While clients are aware that they provide construction work, the construction work is negotiated and discussed at a later time and initial consultations address and focus on design. However, the Taxpayer acknowledged that while the design services are billed on an hourly basis, it is common to frame the budget for the design work as a percentage of anticipated construction costs. However, where the design [work] is budgeted as a percentage of construction cost, this amount is only a [guideline] and the actual cost of the design work may exceed that estimated percentage. The Taxpayer stated that the normal point at which construction is discussed in detail with clients is when the design work shifts to permitting for actual construction. Construction work is substantively negotiated after the design work is complete. The majority of the construction work performed by the Taxpayer is undertaken on a cost plus basis and it generally does not do fixed bid construction work.

The Taxpayer also provided a list of 25 projects, including work done after the audit period, including 13 projects where it performed only design work. For the remaining 12 projects, construction work started between 4 and 24 months after the design work. The Taxpayer also noted that the design work was billed on an hourly basis, and provided a copy of a representative invoice for design services. The Taxpayer also emphasized that payments for design work are also processed separately. It is normal for the design work to be paid by personal check while

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<sup>2</sup> The assessment is comprised of \$ . . . in retail stale tax, \$ . . . in retailing B&O tax, a credit for (\$ . . . ) in service B&O tax, interest of \$ . . . , and a 5% assessment penalty of \$ . . . .

the construction work is frequently compensated through payments from the lender financing the construction work.

The result of the design process is that the customer is provided a full set of construction drawings suitable for obtaining permits, and once that work is complete, the customer is free to retain a different contractor to perform the construction work. The Taxpayer characterized that its selection, as the construction contractor, is generally the result of a competitive process and that approximately 75% of its customers assert that they have talked to, or are considering hiring, other contractors to perform the construction work. However, as the majority of the work at issue is private residential construction, the competition process does not rise to the level of a formal competitive bidding process.

We note that the Taxpayer markets its company as specializing in “design-build” services and specifies that an advantage of retaining the firm is: . . . .

. . .

## ANALYSIS

Generally, a person must collect retail sales tax on the gross amounts it charges to construct, repair, or improve new or existing buildings for that consumer. RCW 82.08.050(2).<sup>3</sup> The person must also pay Retailing B&O tax on the gross amounts charged [to] the consumer. RCW 82.04.050 and .220, WAC 458-20-170 (Rule 170). A person that provides a service, including professional services such as engineering or design services, under most circumstances, is not required to collect retail sales tax, but must pay service and other activities B&O tax on the gross income derived from providing those services. RCW 82.04.290(2). However, when those services are rendered in respect to construction, that service is considered a retail service and the provider is required to collect retail sales tax on the amounts a consumer pays that person for those services.

Rule 170 implements RCW 82.04.050, and states, in pertinent part, that the term “constructing, repairing, decorating or improving of new or existing buildings or other structures” 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.”

Rule 170(1)(e) (emphasis added).

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<sup>3</sup> RCW 82.04.050(2) defines a "sale at retail" to include:

[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 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.)

RCW 82.04.051 specifically addressed the taxation of “services rendered in respect to construction.”<sup>4</sup> Applicable to the dispute at issue here is RCW 82.04.051(3) that provides:

Unless otherwise provided by law, **a contract or agreement under which a person is responsible for activities that are subject to tax as a service under RCW 82.04.290(2), and a subsequent contract or agreement under which the same person is responsible for constructing**, building, repairing, improving, or decorating activities subject to tax under another section of this chapter, **shall not be combined and taxed as a single activity if at the time of the first contract or agreement it was not contemplated by the parties, as evidenced by the facts, that the same person would be awarded both contracts.**

(Emphasis added.)

The statute does not require a fixed agreement that both contracts are to be awarded to the same person, and specifically applies even when there are two separate contracts. Thus, the fact that the Taxpayer subsequently negotiates a separate contract for the construction work is not sufficient to segregate the two activities. When the work is in fact performed by the same person, as is the case for the projects at issue here, to retain the service taxable nature of the initial work, it [is] necessary to show that the parties did not contemplate . . . that the work would be performed by the same person. *Id.* Thus, conversely, if there is evidence that the parties contemplated . . . that the design and construction work would be done by the same person, the design work will also be characterized as a retail service.

In this case, the facts available establish the requisite contemplation. The language in the design contracts provides evidence that the Taxpayer, doing both construction and design work, was contemplated by both parties, [particularly] the selection of the term “anticipated” . . . Additionally, the manner in which the Taxpayer markets its services and emphasizes the benefits of consolidating architectural design work with the construction services, also indicates that both components of the work being performed by the Taxpayer is contemplated by the parties, because this capacity is used to promote the Taxpayer’s services and set them apart from other vendors.

In Det. No. 01-184, 22 WTD 238 (2003) we concluded that design work was properly reclassified as retail where the taxpayer did both design and construction work. In that case, the design contract provided that the deposit or retainer paid for the design work would be credited to the construction contract if the customer contracted with the taxpayer for the construction work within a year of the design work being completed. *Id.* In this case, there is not a comparable credit provision, but similarly, the design contract references future construction

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<sup>4</sup> [(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. RCW 82.04.051.]

work being performed by the same person, which comparably provides evidence that the parties contemplated the Taxpayer providing both design and construction services.

We do not find that the varying length of time between when design and construction contracts are negotiated indicates that there was no contemplation the Taxpayer would provide both services. Neither does the fact that the Taxpayer does provide design only services negate the fact that the parties contemplate that the Taxpayer may provide construction services.

Accordingly, we sustain the Audit's reclassification of the income at issue because there is evidence that the parties contemplated that the construction and design work would be performed by the same person, and this is sufficient to classify the design work as a retail service.

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We affirm the Audit's reclassification of the income at issue from service to retail and the corresponding assessment of retailing B&O and retail sales tax.

#### DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 21st day of May, 2015.