

Cite as Det. No. 13-0306, 34 WTD 001 (2014)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of ) D E T E R M I N A T I O N  
Assessment of )  
 ) No. 13-0306  
 )  
... ) Registration No. . . .  
)

[1] RULE 17001, RULE 228; RCW 82.04.190, RCW 82.32.050, RCW 82.32A.020, RCW 82.32.105: USE TAX/DEFERRED SALES TAX, PENALTIES, INTEREST – GOVERNMENT CONTRACTING, WHOLESALING – SUBCONTRACTOR, WAIVER OF PENALTIES AND INTEREST: The Department denied the taxpayer's petition for reversal of an assessment for use tax/deferred sales tax associated with the taxpayer's status as a government contractor (the taxpayer acted as a subcontractor and performed jobs on federally-owned property). The taxpayer originally reported its income under the wholesaling classification because it obtained resale certificates/reseller permits from the prime contractors. The Department reclassified the taxpayer's income to government contracting and assessed applicable use tax/deferred sales tax, plus penalties and interest. The Department also denied the taxpayer's request for waiver of penalties and interest, finding that the taxpayer did not meet the statutory requirements for waiver.

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.

Valentine, A.L.J. – [Taxpayer] appeals the assessment of use tax and/or deferred sales tax, plus penalties and interest, resulting from sales reclassified from wholesaling to government contracting where Taxpayer received resale certificates or reseller permits from prime contractors, and where Taxpayer did not understand its tax liability as a government contractor. Taxpayer's petition is denied in part but remanded for possible adjustment based on additional documents provided on appeal. [Taxpayer's petition is denied in part and remanded in part.]<sup>1</sup>

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

## ISSUES

1. Pursuant to RCW 82.04.190 and WAC 458-20-17001 (Rule 17001), did the Department of Revenue's (Department) Audit Division (Audit) properly reclassify certain of Taxpayer's subcontractor sales from the wholesaling [business and occupation] tax classification to the government contracting classification, even though Taxpayer obtained resale certificates and/or reseller permits from its prime contractors?
2. Pursuant to RCW 82.32.050, RCW 82.32A.020, RCW 82.32.105, and WAC 458-20-228, did Taxpayer's lack of knowledge about its tax liabilities authorize the Department to waive assessed taxes, penalties, or interest?

## FINDINGS OF FACT

Taxpayer is a Washington corporation that engages in electrical contracting and specializes in commercial projects. During the audit period, Taxpayer performed subcontractor electrical work on federal government property and reported the resulting income under the wholesaling [business and occupation] (B&O) tax classification.

Taxpayer obtained copies of resale certificates and/or reseller permits from the prime contractors responsible for the work projects.<sup>2</sup> Thus, Taxpayer believed the income was properly classified as wholesaling and assumed that it had no retail sales tax or use tax liability associated with these particular jobs. Taxpayer, therefore, prepared its prime contractor bids without consideration for retail sales tax or use tax. Taxpayer was unaware that it was performing subcontracting work on federal government property.<sup>3</sup>

Audit reviewed Taxpayer's business records for the period of January 1, 2008, through December 31, 2011. Audit determined that Taxpayer erroneously reported income under the wholesaling B&O tax classification rather than under the government contracting classification. Audit subsequently issued Taxpayer an assessment in the amount of \$. . . .

The multiple elements of the assessment are as follows: 1) retail sales tax of \$. . . ; 2) retailing B&O tax of \$. . . ; 3) wholesaling B&O tax credited in the amount of \$. . . ; 4) service and other activities B&O tax of \$. . . ; 5) use tax/deferred sales tax of \$. . . ; 6) government contracting B&O tax of \$. . . ; 7) interest of \$. . . ; and 8) 5% assessment penalty of \$. . . . Audit obtained the data on which the assessment was based from Taxpayer's QuickBooks accounting software program.

Taxpayer timely appealed the assessment. Taxpayer primarily objects to the assessment of use tax/deferred sales tax in the amount of \$. . . , plus associated penalties and interest. Taxpayer also contends that errors were made on Audit's Workpapers B-2, C-1, and D. Taxpayer asserts, "There are several items where sales tax was previously paid, items that are not subject to sales

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<sup>2</sup> See WAC 458-20-102 and WAC 458-20-102A. Prior to January 1, 2010, resale certificates were used to substantiate the wholesale nature of a sales transaction. Effective January 1, 2010, reseller permits were issued by the Department to substantiate the wholesale nature of a sales transaction.

<sup>3</sup> . . .

tax and a few errors in posting that were made by the taxpayer that were not identified at the time.”<sup>4</sup>

## ANALYSIS

1. Pursuant to RCW 82.04.190 and Rule 17001, did Audit properly reclassify certain of Taxpayer’s subcontractor sales from the wholesaling B&O tax classification to the government contracting classification, even though Taxpayer obtained resale certificates and/or reseller permits from its prime contractors?

Rule 17001 instructs that special B&O tax and retail sales/use tax applications “pertain for prime and subcontractors who perform certain construction, installation, and improvements to real property of or for the United States.”<sup>5</sup>

If conducted on property . . . [of or for] the federal government, these construction activities are not included in the definition of “sale at retail.”<sup>6</sup> Rather, as Rule 17001(3) explains, “Amounts derived from constructing, repairing, decorating, or improving new or existing buildings or other structures . . . of or for the United States . . . are taxable under the government contracting classification of business and occupation tax.” Government contracting B&O tax is based on “the gross contract price.” *Id.*

Rule 17001(5) provides that retail sales tax does not apply to the gross contract price for any business activities reported under the government contracting classification. Rather, government contractors are defined as consumers under RCW 82.04.190(6) and must pay retail sales or use tax “upon all purchases of materials . . . equipment, and other tangible property which is installed, applied, attached, or otherwise incorporated in their government contracting work.”<sup>7</sup> In addition, they must pay retail sales tax for “purchases and leases or rentals of tools, consumables, and other tangible personal property used by them as consumers in performing government contracting.”<sup>8</sup>

Rule 17001(7) instructs that “use tax applies upon the value of all materials, equipment, and other tangible personal property purchased at retail [or], acquired as a bailee or donee . . . for commercial or industrial use in performing government contracting and upon which no retail sales tax has been paid by the contractor, its bailor or donor.” Thus, as stated in Rule 17001(8), “[T]he use tax applies to all property provided by the federal government to the contractor for installation or inclusion in the contract work.” Rule 17001(9) provides that “the use tax is to be reported and paid by the government contractor who actually installs or applies the property to the contract.”

Taxpayer argues that liability for any use tax/deferred sales tax associated with the assessment at issue should rest with the prime contractors who provided resale certificates and/or reseller

<sup>4</sup> See Taxpayer’s brief, dated January 11, 2013.

<sup>5</sup> See RCW 82.04.280(1) for the B&O tax rate applicable to government contractors.

<sup>6</sup> RCW 82.04.050(12).

<sup>7</sup> Rule 17001(5). [Because the work in this matter was performed on “real property of . . . the United States,” this determination discusses only that language in Rule 17001 and RCW 82.04.190(6) and does not address work performed “for” the United States on non-federal property.]

<sup>8</sup> Rule 17001(6).

permits. Taxpayer asserts that it relied on the certificates and permits in good faith and had no knowledge that the work at issue would be classified as government contracting with accompanying retail sales tax and/or use tax liability.

Audit's position is that the resale certificates and/or reseller permits obtained by Taxpayer are irrelevant because the assessment of use tax/deferred sales tax is applicable to work properly classified as government contracting and not as wholesaling.

We agree with Audit's position. Rule 17001 clearly instructs that prime or subcontractor construction work conducted on property . . . [of or for] the federal government is properly classified as government contracting for B&O tax purposes.<sup>9</sup> Thus, Audit properly reclassified certain of Taxpayer's sales from the wholesaling B&O classification to the government contracting classification. In addition, Rule 17001 clearly lays out a government contractor's retail sales tax and/or use tax liability. We deny Taxpayer's petition on this issue.

2. Pursuant to RCW 82.32.050, RCW 82.32A.020, RCW 82.32.105, and WAC 458-20-228, did Taxpayer's lack of knowledge about its tax liabilities authorize the Department to waive assessed taxes, penalties, or interest?

Taxpayer contends that knowing if property is federal government property can be difficult. Taxpayer asserts that it sometimes must depend on the prime contractor for end user information and explains that it was not aware the jobs at issue involved federal government property.

Under RCW 82.32.050(1), if a taxpayer pays less tax than is properly due, the Department must assess the additional amounts found due and include interest. The Department was required to assess them.<sup>10</sup>

The Department has limited authority to waive or cancel assessed tax. The Department may waive or dismiss the tax itself in the following situation: The assessment of tax was due to reliance on "official written advice" or "written tax reporting instructions" given the taxpayer by the Department to the proven detriment of the taxpayer.<sup>11</sup>

RCW 82.32.105(3) authorizes two circumstances under which the Department "shall waive or cancel interest:"

- (a) The failure to timely pay the tax was the direct result of written instructions given the taxpayer by the department; or

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<sup>9</sup> [Taxpayer had no right to rely on the effect of the reseller permits it received from prime contractors, as a matter of law. RCW 82.04.470 provides: "A seller may meet its burden of proving a sale is a ***wholesale sale*** rather than a ***retail sale*** by taking from the buyer . . . a copy of a reseller permit." RCW 82.04.470 (emphasis added). In this case the Department is not imposing a tax on the sale of Taxpayer to its customer – the Taxpayer was not making a wholesale sale, nor was it making a retail sale, but it was instead engaged in government contracting. The Department is asserting deferred sales tax/use tax on materials ***acquired by (not sold by)*** Taxpayer to perform government contracting. The provisions of RCW 82.04.470 do not apply, because government contractors are statutorily defined as "consumers" and are therefore not taxed as wholesalers or retailers. See RCW 82.04.190(6).]

<sup>10</sup> Det. No. 01-193, 21 WTD 264 (2002).

<sup>11</sup> RCW 82.32A.020(2).

- (b) The extension of a due date for payment of an assessment or deficiency was not at the request of the taxpayer and was for the sole convenience of the department.

The facts of this case do not involve either scenario a) or b) above. Thus, there is no basis on which to waive the assessed tax. In addition, Taxpayer's situation does not meet either of the requirements outlined in RCW 82.32.105(3) with respect to a waiver of interest. Thus, the Department cannot waive the assessed interest.

Neither statute nor rule authorizes the Department to waive assessed tax or interest due to a lack of knowledge on the part of a taxpayer. Nor is the Department authorized to waive penalties on the basis of a taxpayer's lack of knowledge about a tax liability.<sup>12</sup> We also note that taxpayers have the responsibility to know their tax reporting obligations.<sup>13</sup> Thus, we deny Taxpayer's petition on the lack of knowledge issue.

Regarding the issue of Workpaper errors, we remand Taxpayer's appeal to Audit for a review of those items Taxpayer claims are in error.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied in part and remanded in part.

Dated this 10th day of October 2013.

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<sup>12</sup> RCW 82.32.105; WAC 458-20-228.

<sup>13</sup> RCW 82.32A.030.