

Cite as Det No. 12-0284, 32 WTD 260 (2013)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 12-0284
)	
... )	
)	Registration No. . . .
)	Document No. . . .
)	Docket No. . . .
)	

[1] RULE 170; RCW 82.04.050, RCW 82.04.051: RETAIL SALE – SERVICES RENDERED IN RESPECT TO CONSTRUCTION. “Services rendered in respect to” construction means those services directly related to construction that are performed by a person who is responsible for the performance of the construction. Here, the evidence established that a developer was responsible for the performance of the construction.

[2] RULE 111; RCW 82.04.070: GROSS PROCEEDS OF SALES – ADVANCES AND REIMBURSEMENTS. A developer cannot exclude amounts it pays to contractors from the gross proceeds of sales where the evidence does not establish an agency relationship, and the developer was itself liable under the construction contracts to pay the contractors.

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.

Ed Ratcliffe, A.L.J. – The Taxpayer appealed an assessment of retailing business and occupation (B&O) taxes assessed on amounts received for the development and construction of [commercial buildings]. The taxpayer argued that it was engaged as a consultant and agent to facilitate the construction. . . . [The petition is denied with respect to these issues.]<sup>1</sup>

ISSUES

1. Was Taxpayer rendering “services in respect to” construction under RCW 82.04.051?

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

2. Was Taxpayer correctly assessed on the gross proceeds of sales of construction services under RCW 82.04.070, or was it acting merely as an agent for purposes of WAC 458-20-111? . . .

#### FINDINGS OF FACT

[Taxpayer] is an [out-of-state] limited liability company. The Taxpayer contracted with [real property owners (hereinafter, the Owner)] as the developer [for the construction of a new commercial building in Washington, the expansion and renovation of a second commercial building in Washington, and the remodel of a third commercial building in Washington]. Taxpayer was not licensed as a construction contractor in Washington.

The Taxpayer entered into written development agreements (hereinafter, Development Agreements) for the three projects. . . .

Under all of the Development Agreements, Taxpayer agreed to retain the services of a duly licensed general contractor reasonably acceptable to and approved by the owner, selected based on an owner approved competitive selection process among appropriately qualified general contractors/construction managers, for the construction of the project in accordance with the project plan, all pursuant to written agreement, in a form reasonably acceptable to and approved by the owner, between the Taxpayer and the general contractor. While acknowledging that Taxpayer was to retain a general contractor and was not itself a licensed contractor, the Owner disclaimed any contractual or agency relationship to the general contractor except as a third party beneficiary under that [construction] contract. Development Agreements Section 2.04(e). The construction agreements (hereinafter, Construction Agreements) between the Taxpayer and the general contractors each included a separate document that set out the general conditions for the design and construction of the projects (General Conditions Agreements).

Under all of the Development Agreements, the Taxpayer agreed to perform or cause to be performed in a good and workmanlike manner the development and construction of the Project, agreed to further the interests of the Owner with respect to the Project, and agreed to cause the timely completion of the various stages of the Project in accordance with the Project Plan. Development Agreements Section 2.01. Taxpayer agreed to require the general contractor and its subcontractors to complete the projects in a good and workman-like manner free from any material defects. Development Agreements Section 2.04(c).

All three Development Agreements recitals stated that the projects were subject to B&O tax and sales tax.

The Owner paid Taxpayer for project costs. Development Agreements Section 4.01. Taxpayer agreed that the Owner's project costs would be used solely for payment of project costs reflected in the project budget. Development Agreements Section 4.02. For each project, the Taxpayer was paid a "Developer's Fee". This compensation included a preconstruction fee, a construction fee, and reimbursable expenses. In addition, the fee could include incentive compensation and late payments. Developer's Agreement 5.01(a). The Developer Agreements each provided in its

recitals that the Developer's Fee was subject to a certain Riders Regarding Fee Arrangements. There was an additional Fee Arrangement negotiated between an affiliate (or affiliates) of the Owner named in the Developer's Contracts [as provided] in [a] rider. These additional fee arrangements were not requested or provided.

The Taxpayer entered into construction agreements for all three projects. . . . Each of the agreements was signed by . . . the President of Taxpayer. The signature was made under the title "Developer."

The Construction Agreements required the construction contractors to provide all means, methods, materials, labor or other resources necessary to complete their work as set forth in the Construction Agreements. Construction Agreements section 2.1.1.

After acknowledging that Taxpayer had all the obligations and responsibilities set forth in the Construction Agreements and the General Conditions Agreements, Taxpayer agreed to use all practical efforts to enable the contractors to perform their work in an expeditious manner by furnishing and approving in a timely way information required by the contractors. Construction Agreements Article 3.

Under the Construction Agreements, the contractors agreed that Taxpayer retained all legal rights to enforce the construction agreements. Construction Agreements section 9.6. The Owner is named as a third party beneficiary under the agreements. Construction Agreements section 9.8.

Construction Agreements set a guaranteed maximum price for the construction. Construction Agreements Article 5. Taxpayer was obligated to pay the Contractor, pursuant to the procedure contained in Article 11 of the General Conditions Construction Contracts section 5.1.2. Under the General Conditions Agreements for the three projects, Taxpayer was required to forward a certificate for payment to the Owner. The contracts stated in bold type that Taxpayer was not obligated to pay the contractor until the Owner paid the developer (with the understanding that the Owner will pay within 20 days). The taxpayer reserved the right to pay each individual subcontractor and/or materialmen individually. General Conditions Agreements section 11.6.1.

When Taxpayer received invoices from the contractors, it would forward those invoices to the Owner for review, approval, and payment. The Taxpayer provided the copy of one of its invoices for [one of the projects]. The invoice separated billing amounts for its fees and reimbursements from the amounts for the contractor, the architect, other consultants, and miscellaneous costs.

The General Conditions Agreements were acknowledged by the Taxpayer, the contractor, and the architect for each project. The General Conditions Agreements appear to be substantially the same on all primary provisions for the three projects.

Taxpayer was required, to the extent provided by the agreements made with the contractor and architect, to administer the contracts. General Conditions Agreements section 2.2.

The contractors agreed to furnish the Taxpayer and the architect, in writing, information about the subcontractors. The Taxpayer agreed to promptly reply to the contractors in writing any reasonable objections that the Taxpayer, the owner, or the architect had to the subcontractors. General Conditions Agreements section 7.2.1. The Taxpayer had the right to cause the contractor to terminate any subcontract with a subcontractor or sub-subcontractor or any other party with whom the contractor had a contractual relationship to perform the contractor's work. This termination was in the sole and absolute discretion of the Taxpayer. General Conditions Agreements section 7.3.4. Taxpayer reserved the right to perform construction or operations related to the project with the Taxpayer's own forces and to award separate contracts in connection with other portions of the projects or other construction or operation on the sites. General Conditions Agreements section 8.1.1. Change orders were based upon agreement among the Taxpayer, contractors and architects. General Conditions Agreements section 9.1.2. Prior to initiation of a change order, the Owner or Taxpayer was to consult with the contractor regarding the change for purposes of determining the feasibility and estimated cost thereof and any extension in the contract time. General Conditions Agreements section 9.2.4.

For [two of the projects] Taxpayer could, upon ten days written notice, terminate the Construction Agreements with or without cause, if the Taxpayer determined (in its sole discretion), the contractor had not performed its obligations under the contract to the reasonable satisfaction of the Taxpayer. For the [third project], the termination provision provides that it may only be acted upon with cause. General Conditions Documents section 16.2.1. Taxpayer could terminate at any time its Construction Agreements for its convenience upon prior notice to the contractor and architect. General Conditions Documents section 16.4 . . . .

During the period under audit, the taxpayer reported its net development income from the three projects on the excise returns for its affiliate . . . . It reported net development income of \$. . . in 2006 and \$. . . in 2007. It paid business and occupation taxes [under the service and other business activities classification] in the amount of \$. . . .

The Department received a refund request for retail sales taxes in the amount of \$. . . from the Taxpayer dated December 31, 2009. The refund was for retail sales taxes related to the projects named above. . . . The Audit Division denied the taxpayer's refund request and instead assessed retailing B&O tax in the amount of \$. . . , interest in the amount of \$. . . , the late payment of a return penalty in the amount of \$. . . , and the 5% assessment penalty for substantially understating its taxes in the amount of \$. . . .

Taxpayer filed an appeal petition [for correction of the assessment] on March 18, 2011 . . . .

## ANALYSIS

1. Was Taxpayer rendering services in respect to construction?

Retailing B&O tax is imposed upon persons making sales at retail. RCW 82.04.250. Washington also imposes a retail sales tax upon each retail sale in this state. RCW 82.08.020. The term "sale

at retail" or "retail sale" is defined in RCW 82.04.050. The term includes the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to constructing new or existing buildings. RCW 82.04.050(2)(b).

“Services rendered in respect to” construction means those services directly related to construction that are performed by a person who is responsible for the performance of the construction. RCW 82.04.051(1). The statute provides further:

As used in this section, “responsible for the performance” means that the person is obligated to perform the activities, either personally or through a third party. A person who reviews work for a consumer, retailer, or wholesaler but does not supervise or direct the work is not responsible for the performance of the work. A person who is financially obligated for the work, such as a bank, but who does not have control over the work itself is not responsible for the performance of the work.

RCW 82.04.051(4).

Taxpayer agreed to use a general contractor and sub-contractors to perform the construction activities. In the agreements, Taxpayer reserved the right in the construction contracts to perform the construction with its own forces. However, it was not licensed or bonded as a construction contractor in Washington and there is no evidence that it directly performed construction on any of the three projects. Taxpayer did not personally perform the construction.

Under this statute, the issue is whether taxpayer was responsible to supervise or direct the work of the general contractor and the sub-contractors.

The Taxpayer agreed to perform or cause to be performed in a good and workmanlike manner the development and construction of the three projects, agreed to further the interests of the Owner with respect to the projects, and agreed to cause the timely completion of the various stages of the projects in accordance with each project’s plan. Development Agreements Section 2.01.

Taxpayer also agreed to require the general contractor and its subcontractors to complete the projects in a good and workman-like manner free from any material defects. Development Agreements Section 2.04(c).

Moreover, under the Development Agreements, Taxpayer is responsible for the quality and timeliness of the construction. The construction contracts are consistent with this reading. Taxpayer signs the contracts in its own name, has the legal right to enforce the contract, and has the right to terminate the contractor or any subcontractor. By the terms of its contracts, the taxpayer does more than simply review the contractor’s work. It accepted the responsibility to oversee and direct the construction. If it is dissatisfied with the construction work being performed, it has the right to terminate the contractor or direct that a subcontractor be terminated. Accordingly, we conclude that Taxpayer’s development activities are services rendered in

respect to the construction of the [commercial] projects. Taxpayer's petition as to this issue is denied.

2. Was Taxpayer correctly assessed on the gross amount of the construction activities?

RCW 82.04.070 broadly defines "gross proceeds of sales," in pertinent part, as:

[T]he value proceeding or accruing from the sale of tangible personal property and/or other services rendered without any deduction on account of . . . , labor costs, . . . , or any other expense whatsoever paid or accrued and without any deduction on account of losses. (Underlining added.)

Under this broad definition, a service provider may not deduct its own costs of doing business from its gross income, including labor costs. *Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002), citing, *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989).

However, WAC 458-20-111 (Rule 111) [allows] certain "advances and reimbursements" and to be excluded from a business' gross income. Rule 111 provides in part:

The words "advance" and "reimbursement" apply only when the customer . . . alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefore, either primarily or secondarily, other than as agent for the customer . . . .

There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.

The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer . . . , the payment of money, either upon an obligation owing by the customer . . . to a third person, or in procuring a service for the customer . . . which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer . . . makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages. (Underlining added.)

For the rule to apply, [a] true agency relationship between the client or customer and the taxpayer is required. *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 562, 252 P.3d 885 (2011). "The existence of that agency relationship is not controlled by how the parties described themselves" and "standard agency definitions should be used in analyzing the existence of the agency relationship." *Id.* (quoting *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 177-78, 60 P.3d 79 (2003)).

Agency requires a factual determination that both parties consented to the agency relationship and that the principal exercised control over the agent. *Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn. 2d 935, 941 (1993); *see generally Restatement (Third) of Agency* § 1.01 (2006). The person claiming agency status has the burden to prove the existence of the relationship. *Seattle-First National Bank v. Pacific National Bank of Wash.*, 22 Wn. App. 46, 587 P.2d 617 (1978). . . .

[The Owner] retained Taxpayer as the developer of the properties. Taxpayer appropriately focuses on the control retained by the Owner in the development contracts over the developer. The Owner retained approval of the selection process of the general contractor and the general contractor selected. The Owner also controlled payments for the construction in a manner that required disclosure consistent with an agency relationship. The construction contracts indicated that the general contractor would only be paid when Taxpayer received payment from the Owner. However, Taxpayer has failed to establish that the Owner consented to an agency relationship or that the Owner exercised the control necessary to establish an agency relationship.

The Owner explicitly disclaimed that it had a contractual or agency relationship to the general contractor except as a third-party beneficiary. Development Agreements Section 2.04(e). This provision is supported by the fact that Taxpayer failed to disclose itself as an agent when it signed the construction contracts. In addition, the construction contracts indicated the Owner was a third-party beneficiary. Construction Agreements section 9.8. Thus, the parties were consistent in how they characterized the relationships in the contracts. In addition, Taxpayer warranted the quality and timeliness of the construction work it contracted for in its own name and retained the ability to terminate and replace the general contractor or the subcontractors. These facts establish that the parties did not intend an agency relationship and Taxpayer contracted for the quality and timeliness of the resulting project.

Consequently, we conclude that the evidence does not establish an agency relationship and that Taxpayer was itself liable under the construction contracts [to pay the contractors]. Taxpayer was correctly assessed on the gross amount of the contract. Taxpayer's petition as to this issue is denied. . . .

#### DECISION AND DISPOSITION

[The taxpayer's petition is denied with respect to these issues.]

Dated this 17th day of October 2012.