

Washington State Tax Guide

CONSTRUCTION



Forward

This guide has been created to help you better understand the Washington State taxes that apply to your business. It is intended to teach contractors about how various construction activities are taxed in Washington State.

We would like to acknowledge the following organizations for their assistance in the development of this guide and the construction industry tax workshops: the Association of General Contractors; the Association of Washington Business; the Building Industry Association of Washington; the Independent Business Association; and the National Federation of Independent Business. Their help was instrumental in developing this guide and related workshops to best fit the needs of construction industry members.

The information contained in this guide is current at the time of publication. Please remember, state tax laws change on a regular basis and this guide will not reflect any changes made after printing.

If you have questions or want additional information referenced in this guide, please call the Department of Revenue's Telephone Information Center staff with your specific tax questions at **1-800-647-7706 from 7:30 a.m. to 5 p.m. weekdays.** Additional information on services and publications provided by the Department can be found in the back of this guide.

We hope you find this guide beneficial.

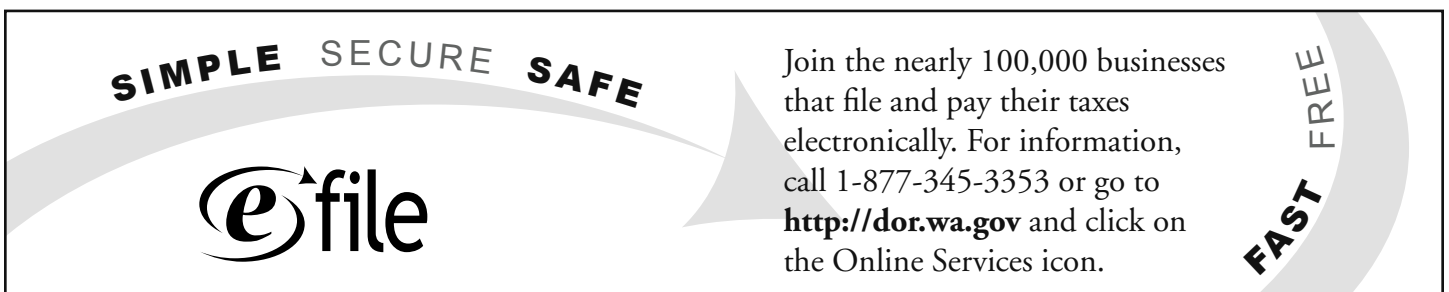


Introduction

To properly report tax, business owners need to understand Washington's business tax system and general application of Business and Occupation (B&O) tax classifications, retail sales tax, and use tax. This guide will help those engaged in construction activities determine their state tax liability. It divides the types of construction into seven categories:

1. Custom construction
2. Speculative building
3. Federal government contracting
4. Public road construction
5. Logging road construction
6. Construction services performed in Indian country
7. Contaminated site cleanup/Environmental Remedial Action

The categories are introduced in the following general overview section. Following the overview is an in-depth discussion of how taxes apply to each of the construction categories.



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Overview of taxes that apply to construction

Washington's excise taxes apply to all business activities conducted in the state. Corporations, partnerships, sole proprietorships, joint ventures, nonprofit organizations, and limited liability organizations, etc., conducting business in this state (whether or not the business has office locations in Washington), are all subject to these taxes.

Businesses subject to any of Washington's excise taxes must register with the Department of Revenue by completing a Master Application. Applications are available at local office locations, through the Department's Telephone Information Center at 1-800-647-7706, and on our web site at <http://dor.wa.gov>.

The following section provides an overview of taxes that apply to construction, construction activities and a general description of the seven categories of construction.

Business and occupation (B&O) tax

This tax is levied on the *gross* receipts of business operations. There are no deductions for labor, materials, taxes or other costs of doing business. (An income tax, by comparison, is applied to the *net* income of business operations.) The nature of the business activity determines appropriate B&O tax reporting.

B&O tax classifications exist for extracting, manufacturing, wholesaling, retailing, government contracting, public road construction, service and other activities, and others. Each classification has its own tax rate. Businesses performing more than one activity may be subject to tax under one or more B&O tax classifications.

Each business owes the B&O tax on its gross income.

Example: A prime contractor with a \$100,000 construction contract hires a subcontractor to perform a portion of the construction for \$20,000. The prime contractor is taxable on \$100,000 and the subcontractor is taxable on \$20,000.

Retail sales tax

Businesses selling goods at retail or performing retail services (such as custom prime construction) must also collect and remit retail sales tax on their total charges unless a specific exemption applies.

This taxable amount includes charges for:

- » permits and other fees
- » labor
- » profit
- » materials
- » charges for subcontractors.

Sales tax rates vary around the state. Contractors performing retail services must collect sales tax based on the tax rate of the jurisdiction in which they perform their services.

Wholesale sales

If your business makes wholesale sales, you do not collect retail sales tax on your charges. However, you must obtain resale certificates from the buyers to document why sales tax was not collected.

Wholesale sales are those made to businesses buying a product or service for resale. Subcontractors on custom construction projects (a wholesaling activity) must receive and accept in good faith a resale certificate from the prime contractor or another subcontractor.

Use as a consumer: Those engaged in construction are considered consumers in regard to tools (purchased or rented) and supplies (items not finally incorporated into the real estate) used in performing the construction. However, depending on the type of construction being performed, the builder may also be considered the consumer of materials incorporated into the job.

Refer to the section addressing the particular construction activity to find the types of items that are used as a consumer. Contractors may not use a resale certificate to purchase items “used as a consumer” in performing construction services.

Purchases for resale

Retail sales tax or use tax is not paid on purchases for resale. This applies to the purchase of items or services that will be resold without intervening “use as a consumer.”

Contractors purchasing items for resale must give the vendor a resale certificate to forgo paying sales tax. If sales tax is paid, the contractor may claim a “tax paid at source” deduction (WAC 458-20-102).

Use tax

This tax is due on items “used as a consumer” when retail sales tax has not been paid. If sales tax has not been paid on purchases of tools, supplies, and materials used in the construction but not incorporated into the real estate improvements, use tax is due.

Use tax is also due on items extracted or produced and used by the contractor in performing the construction. The use tax and sales tax rates are the same. The applicable tax rate is determined by the location where the item is first used or where the construction service is performed.

Deferred sales tax

When goods are acquired without payment of sales tax, but sales tax is due, the sales tax may

be deferred. This most commonly occurs when goods are purchased for dual purposes; i.e., goods both resold and used in the business. A business may give its supplier a resale certificate for goods purchased for dual purposes if the majority of the goods are purchased for resale. While many people assume that use tax is due if goods are used without the payment of sales tax, it’s actually deferred sales tax that is due.

“Deferred” sales taxes means that the payment of sales tax is postponed until it is determined that the goods will not be resold. Deferred sales tax is computed upon the selling price. This includes shipping and handling or freight charges. The **rate of tax** is also the same as if the seller had collected the tax, regardless of contractor’s location.

There is no specific line on the tax return for deferred sales tax. Thus, when completing the tax return, report deferred sales tax on the use tax line (WAC 458-20-102).

Gross contract price – taxable consideration

The gross contract price to provide a construction service is the amount subject to tax. It includes all charges related to a specified job under one contract and all consideration paid without deduction for costs, even if those costs would not be defined as construction services if provided independently of a construction contract.

For example, billings to a customer are part of the gross contract price subject to tax including:

- » building permits
- » engineering fees
- » architectural fees
- » tools
- » tax expenses
- » customer’s payment of the contractor’s liabilities directly to third parties

When a contract calls for progress payments, tax is due on the gross amount billed. Sales tax is

considered collected **only** when stated separately on contract documents and/or sales invoices.

Disputed claims/billings

Tax is due on amounts not paid due to a dispute until the unpaid claim is written off as a bad debt. If additional income results from a court-ordered settlement, the income is considered part of the gross contract amount subject to tax. Some of the settlement funds may be considered by the court to be interest because of late payments. This interest is not part of the gross contract amount, but it is subject to tax under the Service and Other Activities B&O tax classification.

Penalty clause in the contract: If a contractor suffers a loss because of a penalty clause for failure to complete work by a specified time, the financial loss is not deductible from the gross contract price in determining taxes due.

If retainage is not paid because the contractor failed to perform, the lost retainage is not deductible from the gross amount subject to tax.

Construction activities

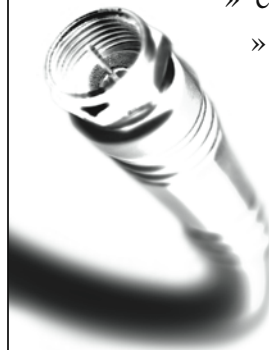
In general terms, construction activities include, **but are not limited to:**

- » installing, repairing, cleaning, improving, constructing and decorating real property
- » constructing and improving new or existing buildings and structures
- » cleaning, fumigating, razing or moving structures
- » cleaning and repairing furnaces and septic tanks
- » clearing land and moving earth
- » drilling oil or water wells
- » building or improving streets, roads, etc.
- » hazardous waste site cleanup

- » radioactive waste cleanup
- » services in respect to the performance of any of the above jobs

In more specific terms, construction activities also include:

- » performance of general contracting
- » construction management
- » construction cleanup/debris removal
- » landscaping
- » painting
- » plumbing
 - » electrical wiring
 - » heat/ventilation/air conditioning
 - » roofing, flooring/carpeting
 - » windows
 - » masonry
 - » concrete
 - » drywall
 - » lighting
 - » windows
 - » framing
- » carpentry
- » trim work



Construction categories for tax purposes

Businesses perform construction activities as prime contractors, subcontractors, or speculative builders. Businesses may perform construction as a prime contractor on one job, a subcontractor on another, and as a speculative builder on yet another project.

Generally, a **prime contractor** is hired by the landowner and a **subcontractor** is hired by a prime contractor. For state tax purposes, the difference between a prime contractor and a subcontractor is only significant on “custom” contracting jobs. Otherwise, a prime and subcontractor are treated the same for tax purposes.

To properly report your taxes, you must determine which category of construction activities you perform. A general description of each of the categories follows. More information on each category of construction activity is detailed in the respective sections of this guide.

1. Custom construction

Involves residential and commercial construction performed for others, including road construction for the state of Washington.

Prime contracting occurs when a contractor is hired by a landowner (or a person having the rights of ownership, such as a lessee or easement holder) to complete an entire construction project. The custom prime contractor may perform all, or a portion of the construction, or hire other contractors (subcontractors) to perform all, or a portion of the work. The income from custom prime contracting (without deduction for any amounts paid to subcontractors) is reported under the Retailing B&O tax classification and is subject to retail sales tax unless a specific exemption applies.

Subcontracting occurs when a contractor is hired by a custom prime contractor to provide a portion of the services necessary to complete the project. Income from custom subcontracting is reported under the Wholesaling B&O tax classification.

2. Speculative building

Occurs when a builder makes improvements on land he or she owns. Speculative builders are not subject to B&O tax or retail sales tax on the sale of the real estate. They are, however, subject to the real estate excise tax. On some projects, the landowner will directly hire different contractors to perform portions of the total

project. In these cases, each contractor hired by the landowner is taxable as a custom prime contractor.

3. Federal Government contracting

This is when a prime or subcontractor engages in constructing, installing, and improving real property of, or for, the United States, its instrumentalities, or a county or city housing authority.

4. Public road construction

Occurs when a prime or subcontractor builds, repairs, or improve streets, roads, etc., owned by a municipal corporation or political subdivision of the state of Washington or the federal government. (This does not apply to roads owned by the state of Washington.)

5. Logging road construction

This happens when logging road construction is directly related to a logging operation.

6. Construction services performed in Indian country

Occurs when construction is performed in Indian country for enrolled tribal members or non-enrolled persons.

7. Contaminated site cleanup/ Environmental Remedial Action

The special B&O tax classification for Environmental Remedial Action expired on July 1, 2003. The activities related to cleaning contaminated sites will be taxed in accordance with the specific activity performed or the predominate activity if multiple activities are performed.

Custom construction

This section refers to all custom construction jobs **except** those specifically defined to be speculative building, federal government contracting, public road construction, logging road construction, construction performed on Indian country, or contaminated site cleanup/Environmental Remedial Action.

Prime contracting

Elements of custom prime contracting:

Generally, the prime contractor on a custom construction job is hired by the owner of the land (or person having the rights of ownership such as lessee) to complete an entire job according to contract specifications. The custom prime contractor may perform the construction services or hire others to perform some, or all, of the work.

Excise tax reporting: Gross receipts from prime contracting on a custom construction job are taxable under the Retailing B&O tax classification and are subject to retail sales tax unless a specific exemption applies.

Custom prime contractors as consumers:

The prime contractor is a consumer of all items that are not incorporated into the final project. In other words, a prime contractor is a consumer of tools, equipment, and supplies used in performing the construction service. As a consumer, the contractor must pay retail sales tax or use tax on such items.

Retail sales tax

Collecting retail sales tax

Prime contractors must collect retail sales tax from the landowner on the gross contract price (without deduction of costs incurred). Billing invoices must separately state the sales tax. If the contract requires retainage, sales tax must be computed before deducting retainage.

The Department presumes that a selling price quoted in any agreement between parties **does not** include the retail sales tax unless that tax is separately itemized. This is true even if the contractor and buyer know and agree that the price quoted includes state and local taxes. **The words “tax included” is not sufficient.** It does not supersede the requirement to separately state the sales tax (RCW 82.08.050).

Bid, contract, pay estimate, or draw request

A contract is written evidence of a sale and should list sales tax as a separate amount. Even though written contract language may state that the selling price includes sales tax, it does not meet the requirement of separately stating sales tax from the selling price. Also, progress billings made against the total contract price of a job should separately state the sales tax. If a contract separately states the tax while individual billings omit the tax, the contract will be satisfactory proof that a separate and identifiable sales tax amount was collected from the customer. If individual billings separate the tax, those billings are proof of tax collected.

Example: XYZ, Inc. custom builds residential homes on Jane Smith's land. XYZ, Inc. has determined that the contract to build is \$162,000 (\$150,000 plus eight percent tax). The table on the right identifies the various ways in which the contractor may write the contract and explain the tax consequences:

Contract Wording	Is Sales Tax Separately Stated?
XYZ, Inc. has a signed contract with Jane Smith which states the selling price is \$162,000 with "sales tax included." XYZ, Inc. was paid \$162,000 in total. There are no other documents supporting amounts received.	NO - The terms "sales tax included" do not quantify the rate and amount of sales tax paid by Jane Smith. \$162,000 x tax rate = sales tax due \$162,000 x .08 = \$12,960 sales tax due B&O tax is due on \$162,000
XYZ, Inc. signs a contract stating the total price is \$150,000 plus \$12,000 sales tax. Progress invoices do not separately state sales tax.	YES - The contract quantifies the rate and amount of sales tax paid by Jane Smith and this information is clearly stated to Jane Smith and XYZ, Inc. \$150,000 x tax rate = sales tax due \$150,000 x .08 = \$12,000 sales tax due B&O tax is due on \$150,000
XYZ, Inc. signs a contract indicating tax was included on total price of \$162,000. However, the invoices separately state sales tax.	YES - The invoices quantify the rate and amount of sales tax paid by Jane Smith and this information is clearly stated to Jane Smith and XYZ, Inc. \$150,000 x tax rate = sales tax due \$150,000 x .08 = \$12,000 sales tax due B&O tax is due on \$150,000

Retainage

You must compute sales tax before amounts for retainage are deducted. Report the full selling price without deduction for retainage under the Retailing B&O tax classification. This is subject to retail sales tax.

Example: School Builders, Inc., has a contract with City High School to renovate the cafeteria for \$100,000. School Builders, Inc., will invoice based on progress of the job. The sales tax rate is eight percent and retainage is five percent. School Builders first progress billing should appear as follows:

INVOICE		
School Builders, Inc. 123 Anywhere St. Olympia, WA 98501 360.000.0000 Fax 360.000.0000		INVOICE NO: 1 DATE: January 6, 2005
TO:	City High School	Billing Period: August 2004
ACTIVITY	DESCRIPTION	AMOUNT
	Completed to date	\$10,000.00
	Billed to date	00.00
	Contract amount due to date	\$10,000.00
Subtotal		\$10,000.00
SALES TAX @ .08		\$800.00
Less retainage (5% of \$10,000)		\$500.00
TOTAL DUE this billing		\$10,300.00
Make all checks payable to: School Builders, Inc. <p style="text-align: center;">THANK YOU FOR YOUR BUSINESS!</p>		

Line item billing

You must collect retail sales tax on the full selling price, which includes costs that are itemized and charged directly to the landowner. These costs are not deductible from the total contract amount. The following invoice illustrates this:

INVOICE		
XYZ, Inc. 123 Anywhere St. Olympia, WA 98501 000.000.0000 Fax 000.000.0000		INVOICE NO: 2 DATE: August 2005
TO: Mr. and Mrs. Jones		Billing Period: July 2004
ACTIVITY	DESCRIPTION	AMOUNT
	Building permit	\$200.00
	Architectural services	500.00
	Dozer rental	\$1,000.00
	Paid dozer rental tax	80.00
	Subtotal	\$1,780.00
	Profit & overhead	178.00
	Subtotal	\$1,958.00
	SALES TAX @ .08	156.64
	TOTAL DUE	\$2,114.64
Make all checks payable to: XYZ, Inc. THANK YOU FOR YOUR BUSINESS!		

Paying retail sales tax

The contractor is the consumer of items purchased for use in the construction process and not used as component parts of the finished structure. Therefore, retail sales tax must be paid to the vendors of such items.

Resale certificates

The purchase of materials by custom contractors that will become part of the completed project are purchases for resale (wholesale). These purchases are not subject to retail sales tax. Custom contractors also can purchase subcontractor services for resale. A prime contractor must give a valid resale certificate to the materials supplier or

subcontractor to verify that material purchases and subcontractor services are for resale.

A resale certificate provides the seller with documentation that the purchases are intended for resale. The certificate must be completed in its entirety and signed by the buyer or other person authorized to make purchases on the buyer’s behalf.

A prime contractor **may not** use a resale certificate to purchase items that are consumed by the contractor in performing construction. Examples of such purchases are equipment, equipment rentals, tools, form lumber or visqueen not incorporated into the structure, duplex nails, and other supplies used in performing the construction.

Contractors who use resale certificates to purchase items or services they use as consumers will be assessed a misuse penalty of 50 percent of the tax due on the improperly purchased item or service. This is in addition to all other taxes, penalties, and interest due (RCW 82.32.291).

On a resale certificate, a buyer must specify the kinds of products or services purchased. A contractor who purchases some items to incorporate into the structure and other items for use as a consumer, must clearly indicate the products or services purchased without paying sales tax (WAC 458-20-102).

The buyer may list the particular products or services to be purchased at wholesale, or provide general category description of these products or services. The terms used to describe these categories must be descriptive enough to restrict the application of the resale certificate to those products or services which the buyer is authorized to purchase at wholesale. “Building materials” or “subcontract work” are examples of terms that may be used by a prime contractor. A buyer purchasing all of the products or services from a particular seller at wholesale may “use all products and/or services” to describe the items.

Example: Residential Construction Co. purchases building materials to incorporate into a project and tools for its own use from Joe's Supply Co. Residential Construction Co. must give Joe's Supply a resale certificate limiting the certificate's application to building material purchases. Joe's Supply must collect tax on the sale of tools from Residential Construction. Consistent with the information included on the resale certificate, sales of building materials will not be subject to sales tax.

If the contractor gives a resale certificate to the seller and later uses the item listed on the certificate, or if the seller failed to collect the sales tax on items not listed on the certificate, the buyer must remit the deferred sales tax due to the Department of Revenue.

Use tax

Use tax is due if sales tax has not been paid on items the contractor uses as a consumer. Normally, use tax is due (if sales tax hasn't been paid) on the following: equipment, tools, supplies, and rentals of equipment, even if the cost for these items is passed along to the landowner. The manner in which the contractor bills to recover expenses of items used as a consumer is inconsequential.

Example: The sales tax or use tax is due on the purchase of a specialized tool for a one-time job even though the purchase price is passed on to the customer as a line item.

Bare rentals of equipment

When contractors rent equipment for construction projects, the contractor is the consumer of the rented item and owes retail sales tax to the rental company. The tax rate for a short term rental (less than 30 days) is the place of the rental business. The tax rate for a long term rental (more than 30 days) is the lessee's location.

Providing tangible personal property along with an operator

The service of providing tangible personal property (equipment) with an operator is generally a retail

sale. Even when a construction contractor rents or hires equipment with an operator, the charges are subject retail sales tax.

But if the business providing the equipment and operator is contractually responsible for the completed construction, such as installing, connecting, or affixing materials to land or buildings, the construction contractor may use a resale certificate to purchase the equipment and operator services. In this limited case, the business providing the equipment and operator reports under the Wholesaling B&O tax classification and sales tax does not apply.

Regarding construction, it will be presumed that providing equipment and operator to a contractor is a retail sale unless it can be demonstrated that the business providing the equipment with operator has responsibility for performing construction to contract specifications and assumes control over how the work will be performed.

Services rendered in respect to construction

"Services rendered in respect to constructing" means contracting to be responsible for the performance of the actual construction.

"Responsible for the performance" means that the person is responsible for the completed construction without regard to who actually performs the construction. A person who only reviews work related to construction but who does not supervise or direct the work is not providing "services rendered in respect to constructing."

A contract to perform professional services (such as engineering, architectural, surveying, etc.) will not be considered "services rendered in respect to constructing" if a subsequent construction contract is awarded separately to the same person. The contracts will be considered as awarded separately, if at the time the professional services contract is awarded, the parties did not contemplate that the same person would be "responsible for the performance" of the construction.

When a single contract calls for both professional services and "services rendered in respect to

constructing,” the total contract price is subject to tax according to the predominant activity performed under the contract.

Construction management services performed for a consumer are considered services rendered in respect to construction and the income is subject to Retailing B&O tax and retail sales tax. This includes those management jobs where the management in substance is prime contracting. Statements in contracts that the “manager” does not have liability for payment of subcontractors or material billings, or does not have final choice over the vendors of these items, does not preclude the activity from being considered services in respect to construction.

Construction Activities and Related Parties

Washington’s tax structure imposes a tax on transactions. Whenever there is a transaction (purchase/sale) between two or more persons (entities), tax generally applies. For tax purposes, individuals as well as any separately organized entities (such as partnerships, corporations, joint ventures, etc.) are separate persons.

Example: A corporate officer is a separate person from the corporation even though the officer may own all of the corporate shares.

Transactions between related entities are treated the same way as transactions between unrelated entities. Persons who perform custom construction upon land owned by related entities are custom prime contractors and must collect sales tax on their charges.

When there is no contract price stated, no billings to support the contract price, or the receipts do not indicate taxable income, the taxable amount is the total amount of construction costs including any charges for licenses, fees, permits, etc., required for construction and paid by the contractor.

Solid fuel burning devices

This is any device for burning wood, coal, or any other non-gaseous and non-liquid fuel, including a wood stove and fireplace. Custom

prime contractors must collect and remit the solid fuel burning device fee, \$30 per device, from consumers for all such devices installed in construction improvements.

Other income

Income received under energy efficient housing credits or union subsidized wages is taxable under the Service and Other Activities B&O tax classification.

Deductions

Following are some deductions applicable to custom construction activities. You should be aware that some deductions are applicable to both the B&O tax and retail sales tax; however, many deductions are only applicable to one or the other tax.

Sales tax paid on materials

A deduction is allowed under retail sales tax for the purchase price of materials incorporated into the structure if sales tax was paid.

Example: If materials costing \$500 plus \$40 sales tax are incorporated into a custom prime contracting job, then a deduction of \$500 is allowed from retail sales tax under the deduction line “Taxable Amount For Sales Tax Paid At Source.”

Construction performed outside this state

Neither B&O tax nor retail sales tax applies to income earned from construction activities performed outside of Washington.

Installation of manufacturing/research and development machinery and equipment

Charges for installing machinery and equipment for manufacturers at a manufacturing site are exempt of retail sales tax. In addition, the cost of the machinery and equipment is also exempt. A manufacturer’s sales and use tax exemption certificate must be secured from the manufacturer (RCW 82.08.02565).

Distressed Area approved projects

The Distressed Area Deferral/Exemption Program grants a waiver of sales/use tax on pre-approved construction of manufacturing research

and development and/or computer-related business facilities, and installation of related machinery and equipment. The contractor is not required to collect sales tax on such charges if the customer presents a deferral certificate from the Department.

Construction in Indian country

See “Construction services performed in Indian country,” page 18.

Agricultural employee housing

Construction of qualifying agricultural employee housing is exempt from retail sales tax when performed for: agricultural employers, housing authorities, federal, state, and local government agencies, nonprofit community or neighborhood-based organizations that are exempt from income tax and for-profit entities. An agricultural employee housing exemption certificate must be secured from the agricultural housing provider.

Alternative housing for youth in crisis

Sales tax does not apply to materials only used in construction performed for health and welfare organizations or Alternative Housing for Youth in Crisis. The contractor must segregate materials from all other charges. All other costs and charges, such as labor, are subject to sales tax.



Other types of prime contracting

Technically, federal government contractors, public road contractors, and logging road contractors may also be prime contractors; however, the taxability of those particular activities is different from that of custom prime contracting jobs.

Subcontracting

A custom subcontractor is a contractor who is hired by a prime contractor to provide a portion of the construction services necessary to make improvements on real estate owned by a third party.

Sales tax should not be collected on the subcontractor’s charges if the subcontractor secures a resale certificate from the prime contractor.

Income from custom subcontracting jobs is reported under the Wholesaling B&O tax classification. (The prime contractor will collect sales tax from the landowner on the total contract price which includes all subcontractors’ charges.)

Generally, subcontractors perform the following services:

- » roofing
- » electrical
- » plumbing
- » concrete paving
- » asphalt paving
- » heat/ventilation/air conditioning
- » excavating/moving earth
- » windows
- » carpeting
- » lighting
- » interior decorating
- » drywall
- » plaster
- » tiling
- » fencing
- » finish work
- » landscape installation

Speculative building

Speculative builders construct residential or commercial buildings on **land they own** (or on real estate for which they are a lessee, or have the right of possession). Speculative builders are subject to real estate excise tax on the selling price of the land along with all attachments including buildings, roads, and other structures. The sale of real estate is not subject to the B&O tax or retail sales tax.

A speculative builder is the consumer of all material incorporated into the real estate. A speculative builder may not use a resale certificate to purchase materials used in speculative building. Any construction contractor hired by a speculative builder is a custom prime contractor for tax purposes and not a subcontractor. Hence, any contractor performing construction services for a speculative builder must charge sales tax on the total contract price.

Land ownership

As explained above, the definitions of custom and speculative building and the resulting tax consequences are based upon the land owner. Building on land owned by another is prime construction (unless specifically defined otherwise) and building on your own land is speculative construction. Therefore, land ownership must be established to determine the proper tax application to the construction work performed.

The property owner is generally the holder of the recorded title, but it is possible for a person to hold title to real property that he/she does not own. Therefore, attributes of ownership, other than the property title, may determine the tax application.

Four criteria can be used in determining who holds the attributes of real estate ownership (other criteria may be used as well). They are:

1. The intentions of the parties in the transaction under which the land was acquired.
2. The person who paid for the land.
3. The person who paid for improvements to the land.

4. The manner in which all parties, including financiers, dealt with the land.

The attributes of ownership establish who has the rights and liabilities of a property owner. That is, who has the ownership rights and liabilities to the extent that a court would call that person the owner of real property, despite the fact that someone else may hold mere bare title to the property. Holding documentation that, by itself, labels a party to the transaction as landowner does not override the other attributes of ownership if those attributes are held by another person.

Example:

Party A - Original Landowner/Seller

Party B - Contractor/Nominee

Party C - Customer/Purchaser

Party A wishes to sell its land. Party C wishes to purchase Party A's land and have Party B construct a house on it. For financing purposes, title is first transferred to Party B as nominee for Party C. At this point, the title will show Party B as "Grantee and Nominee." Then Party B constructs the home. Afterwards, Party B transfers title to Party C.

Although Party B is shown as title holder during construction of the home, he/she does not have the attributes of ownership. Therefore, Party B is not a speculative builder of the home, but is a custom prime contractor to Party C.

Reference: WAC 458-20-170

Certain title transfers will be disregarded

When real estate owner sells to a builder who improves the property and then resells the property back to the original owner, the builder is not taxable as a speculative builder. The total activities are taxed as custom prime construction.

Pre-sales agreements

Additionally, a prospective buyer will not be the owner of land by merely executing a purchase and sale agreement or pre-sale agreement with the contractor (even if a substantial amount of money is paid). In this

case, there has not been a transfer of ownership rights and liabilities until the closing has taken place.

Selling a speculative home during the course of construction

When a speculative builder sells or contracts to sell property upon which there is a building under construction, all construction completed subsequent to the date of such sale or contract constitutes custom prime contracting.

The “retail sale” does not take place until the purchasers have the “right of possession” to the real property being constructed. Typically, the right to possession is transferred on the date of closing the property conveyance. Therefore, retail construction on what was originally a speculative house does not occur until after closing.

Joint ventures

The formation of a joint venture is a common way to accomplish the development of real estate. Many times the members of the joint venture include a person who owns property (landowner member) and a general contractor (contractor member). The formation of a joint venture is the creation of a third entity.

When construction takes place on the property, tax consequence is determined by the answers to the following questions:

1. Which entity owns the land? Does a member or joint venture entity own the land?
2. Which entity is providing the construction services? Is a member performing the construction services as a separate entity (prime contractor for the joint venture or landowner) or is the joint venture performing the construction services itself (contractor is performing service as a member of joint venture)?

The answers to these questions will determine the tax liabilities of the joint venture entity and specific members.

If construction services are performed by a member as a separate entity on land owned by one of the other entities (the joint venture entity or landowner), the construction services are taxable as custom prime contracting. The contractor must collect retail sales tax on the full contract price (labor and materials) from the landowner. This is true even if the contractor is a member of the joint venture.

When a joint venture owns the land and the contractor performs construction services as a member of the joint venture (versus a separate entity), the joint venture is a speculative builder. In this case, the work performed by the contractor is a contribution to the capital of the joint venture. The joint venture entity must pay retail sales tax or use tax on materials purchased or produced for incorporation into the real estate.

To be treated as a speculative builder, a joint venture entity must actually exist and the joint venture entity must own the land **and** perform the construction itself.

Land ownership is established by the attributes of ownership as discussed above. The following factors are significant in determining whether construction activities are performed by a joint venture or by other parties involved in the construction:

- » Was the joint venture specifically formed to perform the contract work?
- » Did the formation of the joint venture begin prior to construction?
- » Was the construction work actually performed by the joint venture (versus by a separate entity)?
- » Were the funds handled as joint venture funds rather than as separate funds of any party to the joint venture agreement?
- » Was there a contribution of money, property and/or labor so that any profit or loss incurred by the joint venture is proportionately shared by all members?

Where a member is guaranteed a fixed amount as compensation for construction services independent of any right to profit or gain, such amount is taxable as custom prime contracting.

Road building on speculative projects

The construction of roads on private property by a prime contractor is a retail sale subject to retail sales tax on the full contract price (labor and materials). But when the road will be deeded to a city or county, the construction is taxable as public road construction. In this case, the road contractor's charges to the speculative builder are not subject to retail sales tax. A road contractor is the consumer of all materials it incorporates into the roads; thus, the road contractor must pay retail sales tax or use tax on such materials. This includes materials provided by the speculative builder. However, if the speculative builder (landowner)

has paid retail sales tax or use tax on the materials, the tax is not due again from the road contractor.

The speculative builder remains a consumer with regard to all materials purchased or produced for incorporation into the road. Therefore, the speculative builder must pay retail sales tax or use tax on materials provided to the road contractor. In this case, both contractors are consumers with liability for payment of retail sales tax or use tax on materials. However, the value of the materials is only subject to the tax once. Therefore, when one contractor has paid the tax, the tax liability has been satisfied with regard to those materials.

If the road is not finally dedicated to the public body within a reasonable period of time after the work is completed, the speculative builder will be liable for use tax on the charges of the road contractor. A reasonable period of time has generally been limited to one year or less.

Government contracting

Government contractors, either as prime or subcontractors, perform construction, installation, and/or improvements to real property of, or for, the United States, its instrumentalities, or a county or city housing authority. This category does not apply to federal road construction (see “Public road construction” on pages 15-16). The activities include, but are not limited to:

- » constructing, repairing, decorating, and improving new or existing buildings or other structures
- » installing and attaching tangible personal property to new or existing buildings or other structures
- » clearing land
- » moving earth

Gross income from such construction is subject to the Government Contracting B&O tax.

Construction activities performed to improve real property of, or for, the U.S. is not a retail sale. It is prohibited under the federal constitution to directly impose a tax on the federal government. Accordingly, the government contractor does not collect sales tax on charges for such work.

Activities such as the mere sale of tangible personal property or providing professional services to the federal government are not reported under this classification.

Government contractor as the consumer

The government contractor is the consumer of property incorporated in, installed in, or attached to the federal construction job. The contractor (prime or subcontractor) must pay sales or use tax on all materials which become a physical part of the project. This includes items manufactured or extracted by the contractor, and also includes property provided by the federal government.

A government contractor is also a consumer of machinery and equipment provided by the government. Use tax is due on the reasonable rental value of the equipment provided.

A Certificate of Sales or Use Tax Paid may be furnished by the prime contractor or a subcontractor to other contractors as proof that sales or use tax was paid on materials.

Subcontractor’s charges to prime contractors on government contracting jobs are not subject to sales tax.

Public road construction

Public road construction is the activity of building roads, streets, sidewalks, etc., owned by cities, counties, or political subdivisions of the state or the United States which are primarily used for foot or vehicular traffic. Both prime and subcontractors engaging in these activities are subject to Public Road Construction B&O tax. Public road contractors do not collect retail sales tax.

Building roads owned by the state of Washington, privately owned, or owned by tribes on their Indian reservations, is not public road building. These activities are taxable as custom contracting. There is an exemption from retail sales tax for construction on land owned by tribes on their Indian reservations.

Public road building activities

The terms “building, repairing or improving of a publicly owned street, place, road, etc.,” **include**:

- » clearing, grading, graveling, oiling, paving, and the cleaning thereof
- » constructing of tunnels, guard rails, fences, walks and drainage facilities
- » planting of trees, shrubs and flowers therein;
- » placing of street and road signs
- » striping of roadways
- » painting of bridges and trestles
- » construction of road and street lighting systems, even though portions of such systems are also used for purposes other than street lighting
- » construction of a drainage system in roads, even though such systems are also used for the carrying of sewage (storm sewage)
- » mining, sorting, crushing, screening, washing and hauling of sand, gravel and rock taken from a public pit or quarry
- » construction of certain mass transit buildings for mass transit authorities

The terms “building, repairing or improving of a publicly owned street, place, road, etc.,” **do not include**:

- » constructing water mains, telephone, telegraph, electrical power, or other conduits or lines in or above streets or roads, unless such power lines become a part of a street or road lighting system
- » constructing of sewage disposal facilities (sanitary sewers)
- » installing of sewer pipes for sanitation unless within, and a part of, a street or road drainage system
- » construction, repairing, improving parking lots (unless part of a mass transportation facility)

Roads dedicated to the city or county

Additionally, construction of streets or roads dedicated to a city or county is public road construction. If the road is not finally dedicated to the public body within a reasonable period of time after the work is completed, retail sales tax applies.



Public road contractor as the consumer

Public road contractors (both prime and subcontractors) are consumers of materials they incorporate as an ingredient or component of a road. Public road contractors must pay retail sales or use tax on all materials they place in, or on, the road as well as on equipment and supply purchases. This applies to materials whether they are purchased, provided by others, or manufactured/extracted by the contractor.

A Certificate of Sales or Use Tax Paid may be furnished by the prime contractor or a subcontractor to other contractors as proof that sales or use tax was paid on materials.

Manufacturing/extracting materials by the contractor

Off-site asphalt plants

The production of asphalt away from the road construction site is a manufacturing activity. The value of the material produced is subject to the Manufacturing B&O tax and use tax. The taxable value is equal to all costs incurred to produce the asphalt, including labor and overhead.

Rock

The removal of rock from either a pit owned by the road builder or from pits owned by or leased to the public authority is considered extracting. The value of the rock is subject to Extracting B&O tax. If the contractor also applies the materials to the road, the value of the rock is subject to use tax. The value is determined by the total costs attributable to the extracted and processed rock, including raw material, extraction and processing costs, overhead, and any transportation costs between the extraction site and the processing site.

Job site plants

The production of asphalt at a public road construction job site pursuant to performing a road construction contract is not manufacturing. Sales tax or use tax is due on the value of the raw materials used to produce the asphalt.

Processing rock for placement by political subdivisions

B&O tax does not apply to the cost of, or charge made for, labor and services performed in respect to the mining, sorting, crushing, screening, washing, hauling, and stockpiling of sand, gravel, and rock. This is true when such sand, gravel, or rock is taken from a pit or quarry which is owned by or leased to a county or city and is:

- » stockpiled in the pit or quarry for placement on the street, road, or highway by the county or city itself using its own employees; or
- » placed on the street, road, or highway by the county or city itself using its own employees; or
- » sold by the county or city at actual cost to another county or city for road use.

In this case, since the rock processor is not applying the materials to the road, it does not owe use tax on them.

Material providers

A business that simply sells (doesn't apply or spread) materials without performing public road construction activity is not in the business of public road construction. They must collect retail sales tax on total charges for materials (including delivery charges) from the purchasing contractor.

Bifurcation of contract activity

Public road construction includes the business of building, repairing, or improving any street, place, road, etc., which is owned by a municipal corporation or political subdivision of the state or the United States. Road work completed on property owned by the state or an individual is not public road construction.

The definition is based on who owns the road, not who pays for the road work. Therefore, a road contract with the state which includes improvements to a passage of road owned by the United States is part retail and part public road construction. In this case, only part of the total construction is taxed as public road construction. The remainder is taxed as custom construction.

Logging road construction

Building roads directly related to a timber harvesting operation is considered logging road construction. Such activities include maintaining logging roads as well as the original road construction. The gross contract price is taxable under the Extracting/Extracting for Hire B&O tax classification. Also, the contractor owes Extracting/Extracting for Hire B&O tax and use tax on the value of materials extracted for the job. Private road construction in any other context is a sale at retail.

Logging road contractors are the consumers of any materials they incorporate into the roads. The contractor must pay retail sales or use tax on the value of the materials. If the contractor has not purchased the materials, he or she must pay

use tax based on the value of the materials. For example, rock includes rip rap, pit run, crushed rock, and other rock products used in logging road construction. The value of the rock extracted and/or applied to the roads is the total cost attributable to extracting and processing.

Total cost includes:

- » raw material
- » extraction and processing costs
- » overhead
- » any transportation costs between the extraction site and the processing site, if it is extracted by the contractor
- » transportation from the processing site to the job site

Construction services performed in Indian country

Definitions

For purposes of the following discussion, these definitions apply:

“Indian” means a person on the tribal rolls of an Indian tribe, also known as an “enrolled member,” “member,” “enrolled person,” “enrollee” or “tribal member.” The term “Indian” includes only those persons who are enrolled with the tribe upon whose territory the activity takes place and does not include Indians who are members of other tribes. An enrolled member’s spouse is considered an “Indian” for purposes of this rule if this treatment does not conflict with tribal law.

“Indian country” means all land within the limits of any Indian reservation. In addition, Indian country includes trust land located outside of a reservation. This includes allotments that have restricted land status. “Restricted land” is identified by title that is vested in an Indian or tribe, and the property is subject to federal restrictions on alienation and encumbrance.

“Tribe” means an Indian nation, tribe, band, community or other entity recognized Indian Tribe by the United States’ Department of the Interior. “Federally recognized Indian tribe” and “tribe” have the same meaning as “Indian tribe.”

“Materials” are items that become a permanent part of the finished construction, provided that the items have not previously been used or consumed in the performance of the construction activity. For example, “materials” include concrete, tie rods, lumber, windows, roofing, etc., which become part of the structure being built or improved.

“Consumables” are items and services consumed during the construction. This includes rental equipment with or without an operator. Consumables include form lumber, sand paper, saw blades, equipment and tools.

Prime contractor working directly for tribal members in Indian country

The tax application in these instances is markedly different from most other construction contracts. The tax treatment discussed in this section applies to construction in Indian country by those persons dealing directly with tribes and enrolled members. Additional information is available by referring to WAC 458-20-192.

Retail sales tax: Retail sales tax does not apply to the construction charges of a prime contractor to a tribe or enrolled member when the construction is performed in Indian country. In the case of construction that is performed both inside and outside Indian country, only the portion of the contract that relates to work done in Indian country is excluded from tax. The work done for a tribe or Indian outside of Indian country – for example, road work that extends outside of Indian country – is subject to retail sales tax.

B&O tax: B&O tax does not apply to the construction charges of a prime contractor to a tribe or enrolled member when the construction is performed in Indian country. Resale certificate: A prime contractor may use a resale certificate to purchase materials and subcontractor labor for construction in Indian country for tribal members. These are considered to be purchases for resale.

Use tax: Prime contractors do not owe use tax on the materials permanently installed or affixed to real estate in Indian country when the construction is performed for the tribe or an enrolled member. Prime contractors do not owe use tax on consumables or services consumed in performance of such construction.

Rentals: Prime contractors working in Indian Country do not owe sales or use tax on equipment rentals with or without an operator, when the equipment or services are delivery to the prime contractor on the reservation.

Subcontractor working for prime contractor in Indian country

Subcontractors working in Indian country are generally taxed as if the construction occurred outside of Indian country. In other words, subcontractors are not afforded any favorable tax treatment when performing work for a prime contractor who is performing work for an Indian or Indian tribe.

Retail sales tax: Retail sales tax does not apply if the subcontractor obtains a resale certificate from the prime contractor. This is true even though the prime contractor is not required to collect sales tax from the enrolled member.

Use Tax: Subcontractors do not owe use tax on the materials permanently installed or affixed to real estate in Indian Country when the construction is performed for the prime contractor. Subcontractors do owe use tax on consumables or services consumed in performance of such construction.

Rentals: Subcontractors working in Indian Country owe sales or use tax on equipment rentals with or without an operator.

Construction in Indian country for non-enrolled persons

Prime Contractors

Construction performed for non-enrolled persons is treated like construction that occurs outside of Indian country. Retail sales tax: Retail sales tax applies on the prime contractor's charges for construction performed in Indian country for persons or business that are not enrolled tribal members.

B&O tax: The B&O tax applies on the prime contractor's charges for construction performed in Indian country for nonmembers. Resale certificate: A prime contractor may use a resale certificate to purchase materials and for subcontracts for construction in Indian country for nonmembers.

Use tax: Prime contractors owe use tax on materials or services consumed in performance of

such construction when sales tax is not paid.

Rentals: Prime contractors working in Indian country owe sales or use tax on equipment rentals with or without an operator, when the rentals are used during construction for a non-enrolled person.

Subcontractors

Retail sales tax: Subcontractors are not required to charge sales tax if a resale certificate is obtained from the prime contractor.

B&O tax: Subcontractors who have obtained a resale certificate from the prime contractor report under the Wholesaling B&O tax classification.

Resale certificate: Subcontractors may use a resale certificate to purchase materials and subcontractors to be used for construction in Indian country for nonmembers.

Use tax: Subcontractors owe use tax on consumables or services consumed during such construction when sales tax is not paid.

Rentals: Subcontractors working in Indian country owe sales or use tax on equipment rentals with or without an operator.

Construction funded by the federal government

The treatment described above relating to construction for tribes and tribal members do not apply to construction for the federal government. Please refer to WAC 458-20-17001 for the tax application for such work.

Retail sales tax: Both prime contractors and subcontractors are not required to charge sales tax when performing construction in Indian country for the federal government.

B&O tax: Both prime contractors and subcontractors are taxable under the Government Contracting B&O tax classification.

Use tax: Both prime contractors and subcontractors owe use tax on the materials used in the construction. Both prime contractors and subcontractors owe use tax on items and services

consumed during such construction. In addition, all contractors must pay use tax any items loaned (bailed) by the federal government to the contractor to perform the construction.

Documenting tax-exempt transactions recordkeeping

Contractors providing construction services to tribal members in Indian country must verify the tax-exempt status of the tribal members by reviewing the buyer's identification and by obtaining a completed *Buyers Retail Sales Tax Exemption Certificate* from the buyer. Examples of acceptable identification are:

- » Tribal membership card
- » Letter from tribal official
- » List of tribal members from a tribal official
- » Treaty fishery identification card

Taxpayers are required to maintain appropriate records on the tax-exempt status of transactions. Records of tax-exempt sales must be maintained for five years. Individual businesses may contact the Department to determine how best to keep records for specific situations.

Questions about tribal government and administration may be directed to the Governor's Office of Indian Affairs at www.goia.wa.gov or at:

General Administrative Building
210-11th Avenue SW, Suite 415
PO Box 40909
Olympia, Washington 98504-0909
(360) 902-8827

Current Indian Tribes

Preemption of tax as explained above is allowed for federally recognized tribes and their members. As of the date of this notice, the following tribes are federally recognized:

- » Chehalis Confederated Tribes
- » Colville Confederated Tribes
- » Cowlitz Tribe
- » Hoh Tribe
- » Jamestown S'Klallam Tribe
- » Kalispel Tribe
- » Lower Elwha Klallam Tribe
- » Lummi Nation
- » Makah Tribe
- » Muckleshoot Tribe
- » Nisqually Tribe
- » Nooksack Tribe
- » Port Gamble S'Klallam Tribe
- » Puyallup Tribe
- » Quileute Tribe
- » Quinault Nation
- » Samish Nation
- » Sauk-Suiattle Tribe
- » Shoalwater Bay Tribe
- » Skokomish Tribe
- » Snoqualmie Tribe
- » Spokane Tribe
- » Squaxin Island Tribe
- » Stillaguamish Tribe
- » Suquamish Tribe
- » Swinomish Tribe
- » Tulalip Tribes
- » Upper Skagit Tribe
- » Yakama Nation

Contaminated site cleanup/Environmental Remedial Action

Effective July 1, 2003, the Revised Code of Washington (RCW) that oversees the special B&O tax rate for Environmental Remedial Action (ERA) expired. Several sections of another RCW also expired on the same date, so people who perform ERA are no longer considered consumers and ERA is once again included in the definition of a retail sale. See RCW 82.04.2635, section (10) of RCW 82.04.050, section (9) of RCW 82.04.190.

Beginning July 1, 2003, contaminated site cleanup will be taxable based on the specific activity performed. Tax treatment for specific activities is discussed below.

Service activities

The following activities that may be performed relative to the clean up of a contaminated site are service activities:

- » Monitoring
- » Treating groundwater
- » Waste disposal
- » Testing
- » Surveying
- » Engineering and design services
- » Consulting
- » Planning services
- » Other activities, not elsewhere defined in Chapter 82.04 RCW

If you perform the above activities you are subject to B&O tax under the Service and Other Activities B&O tax classification and will owe sales tax or use tax on all materials consumed on the job.

Retail activities

Improvements to real property are a retail activity if performed for a consumer and unless otherwise provided by law (for example, improvements to

buildings for the federal government are not a retail activity). Retail activities include the following:

- » Repairing, improving, or cleaning an existing building or structure
- » Razing an existing building or structure
- » Removing underground tanks
- » Installing a cap over contaminated soil
- » “Cleaning” contaminated soil when performed in conjunction with the razing and/or construction of a building or structure such as a dry cleaner or a gas station

If you make such retail sales you are subject to the Retailing B&O tax and must collect sales tax from the consumer. Subcontractors who receive a completed resale certificate from a contractor and are performing activities that would otherwise be subject to Retailing B&O tax are subject to the Wholesaling B&O tax (sales tax is not collected).

Hauling activities

If you merely transport contaminated materials, you are subject to either the motor or urban transportation classification of the public utility tax.

Combination contracts – services rendered in respect to construction

Contracts that formerly came within the definition of Environmental Remedial Action may include a combination of service and retail activities. After June 30, 2003, such contracts are taxable in accordance with the predominant activity of the contract. For example, if you are responsible for razing a gas station, removing the underground tanks, and cleaning contaminated soil, all income associated with these activities will be subject to the same tax treatment as the razing and removal, that is, as a retailing activity.

Cleaning bare land or water

The clean-up of unimproved land or water – for example, at the site of an oil spill on an undeveloped beach – receives specific tax treatment. This law remained unchanged with the expiration of the Environmental Remedial Action statutes. Gross revenue from these types of clean-ups is subject to the Service B&O tax classification. The activities may include the following:

- » Skimming oil off water
- » Using absorbents to remove oil from land or water
- » Pumping oily water from a vessel and disposing of waste water
- » Cleaning contaminated fowl or mammals
- » High pressure washing of land

Environmental Remedial Action

(in effect July 1, 1998 – June 30, 2003)

This B&O classification applied to prime contractors, subcontractors and professional service providers performing environmental remedial action. Charges for environmental remedial action were subject to that tax at the rate of 0.471 percent and were not subject to retail sales tax. “Environmental Remedial Action” was defined as a service relating to identification, investigation or clean-up of hazardous substances resulting from a release or threatened release in one of the following three situations:

1. Action conducted independently by the owner of the contaminated site provided the action is conducted equivalent to MTCA or Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) standards;

2. Actions conducted by site owners or operators in response to an agency order or court issued consent decree with the Environmental Protection Agency or the Department of Ecology; or
3. Action conducted or supervised by the Environmental Protection Agency or the Department of Ecology.

A site is eligible for Environmental Remedial Action after the information on specified forms has been submitted, via certified mail, to the departments of Ecology and Revenue. The Department of Revenue will respond in writing to the owner within 30 days confirming receipt of the certification of eligibility.

It is important to note that environmental remedial action contractors were “consumers” under the Revised Code of Washington and owe retail sales tax or use tax on tangible personal property they apply or install in performing such contracts (RCW 82.04.190).



Audit process

Before the audit

The Department of Revenue selects businesses for routine audit to determine whether the proper state excise taxes have been reported and paid. After receiving an audit assignment, the auditor usually contacts the business by telephone to make an appointment. A letter confirming the date and identifying the audit period and records to be examined usually follows.

The auditor also asks the business to complete a Washington Business Activities Statement and identify any affiliates, subsidiaries, and divisions.

The statutory period covers the four preceding calendar years, plus the current year through the end of the last calendar quarter (RCW 82.32.050).

The statutory period does not apply if:

- » a taxpayer has not registered as required by statute;
- » fraud or a misrepresentation of material fact is present; or
- » the taxpayer provides a written waiver extending the period.

What occurs during an audit?

During an audit, the auditor will:

- » verify income — amounts and classifications reported on return
- » reconcile calendar year sales
- » verify deductions and exemptions
- » verify sales or use tax paid on capital assets, consumable supplies, and articles manufactured for commercial or industrial use
- » review Washington State tax returns, along with state apportionment schedules and consolidating work papers
- » review federal income tax returns for the business
- » review summary accounting records and source documents

- » review journals, such as check registers, the general ledger, sales journal, general journal, cash receipts journal and any other records used to record income and expenses
- » review/test sales invoices
- » review/test purchase invoices (i.e., accounts payable, receipts)
- » review depreciation schedules listing all assets acquired during the audit period along with purchase invoices for those assets
- » review resale certificates for any wholesale sales made
- » review supporting documentation for all deductions and exemptions
- » review annual reports
- » review other documents as necessary

Computer Assisted Audit Program

To provide better service to Washington's taxpayers, the Department has developed the Computer Assisted Audit Program (CAAP). The primary purpose of CAAP is to gather and review taxpayer data in an electronic format. CAAP benefits taxpayers by:

- » increasing efficiency by reducing the time, effort, and human resources necessary to conduct an audit
- » maximizing consistency and fairness obtained from the efficiencies relating to stratified sampling
- » minimizing the detailed review of support documentation while maintaining sound auditing procedures
- » allowing continual access and review of data throughout the audit process
- » providing a foundation for auditing in an Electronic Data Interchange (EDI) environment

After the audit

At the end of each audit, the auditor will hold an exit interview. At this time, the auditor will discuss the findings and present the taxpayer with a draft of the audit schedules. The taxpayer will either agree or disagree with the audit findings. Upon completion of the field work, an internal review process occurs before the taxpayer receives the final notice of assessment.

The auditor provides copies of applicable schedules, laws, rules, and an opportunity to pay the tax and interest. Paying the assessment at the end of the field audit prevents additional interest from accruing.

The auditor then prepares the final audit report for the review process. A field audit manager reviews the audit before submitting it to the Audit Division's audit review unit. The audit review unit processes the audit and issues the notice of assessment. It commonly takes six to eight weeks to receive the final audit package, which includes the notice of assessment, auditor's detail of differences and instructions to the taxpayer, audit schedules, and applicable rules (WAC) and laws (RCW).

Notices of assessments with tax deficiencies require payment within 30 days from the date the audit is mailed. Notice of assessments with overpaid taxes will receive a credit notice that can be applied to future returns. A business wishing to receive a refund rather than a credit may advise the auditor of that preference.

Businesses disagreeing with the auditor's findings may request a supervisor's conference. This is an informal process in which the field audit manager contacts the taxpayer to discuss areas of disagreement. If the field audit manager agrees with the taxpayer, the auditor will make the necessary corrections.

If the field audit manager agrees with the auditor's application of the law, the taxpayer may submit a formal written appeal to the Department's Appeals Division.

Formal appeal process

The director of the Department of Revenue is required to provide an adequate system for reviewing the actions of the Department or the actions of its officers and employees in the assessment or collection of taxes. The Department's Appeals Division fulfills this function in its primary role to resolve taxpayer appeals arising from such actions.

Tax policy specialists functioning under the working title of "administrative law judge" review and determine appeals. The administrative law judges are attorneys specially trained in Washington's tax law. After considering the taxpayer's appeal, the administrative law judge issues a written determination or letter ruling which grants, denies, or modifies the tax assessment or departmental action (RCW 82.01.060).

Time period for appeal

If you disagree with audit findings you may make a formal appeal to the Appeals Division. Any appeal must occur within 30 days of the date of the notice of assessment or by the due date of the assessment, whichever is later. A taxpayer who does not appeal within this time must first pay the assessment. After payment, the taxpayer may then petition the Appeals Division for a refund.

A copy of the Washington Administrative Code that explains the appeals/petition for refund process (WAC 458-20-100) is included with each notice of assessment. The WAC also provides a sample petition for appeal. The appeal must be mailed to:

Appeals Division
Washington State Department of Revenue
PO Box 47460
Olympia, Washington 98504-7460

Categories of appeals

There are **five** categories of appeals:

1. **Mainstream** appeals constitute the majority of all appeals. An appeal is mainstream unless it falls into one of the other categories.

2. **Requests for reconsideration** allows a taxpayer who feels that an administrative law judge has erred in issuing a determination to request a reconsideration of the decision. The administrative law judge who heard the original appeal will usually review for reconsideration. As with other appeals, a request for reconsideration must be filed within 30 days of the original decision.

3. **Small claims** appeals provide an expedited review of the appeal, within 90 days, for cases in which the disputed amount is \$5,000 or less in tax and \$10,000 or less in interest or penalties. A taxpayer may request that the appeal be heard under the small claims program. The Department may decline the request if the issue is a matter of first impression (no Department precedent), involves complex factual, legal or constitutional issues, or includes multiple issues. Appeals heard under the small claims program are not eligible for reconsideration.

4. **Executive-level** appeals provide review of appeals having industry-wide significance or impact, or for which there are no previous precedents by the Appeals assistant director, or in some cases, the executive management team.

A taxpayer may request an executive-level appeal; however, the Department alone determines whether an appeal will be given such consideration. Executive-level appeals are not eligible for reconsideration.

5. **Appeals of revocation proceedings** provide a prompt and independent administrative review of a decision to revoke a tax registration.

Taxpayers who disagree with a determination issued by the Appeals Division may petition for appeal to the Board of Tax Appeals within 30 days of the date of the determination. A taxpayer filing an appeal must pay the tax by the due date, unless other arrangements are made with the Department of Revenue.

Unless a bond is posted, the Board's acceptance of the petition does not stop the collection activity by the Department of Revenue.

A taxpayer who disagrees with a tax assessment or a determination issued by the Appeals Division may directly petition the Superior Court of Thurston County for refund. Payment of the tax assessment is necessary before the court will entertain such a petition.

Summary

Out-of-state contractors

Construction contractors who perform construction activities within this state are subject to Washington's excise taxes, even if they don't have a place of business within this state. Those contractors must register with the Department of Revenue and report taxes generated from their activities within Washington State.

Use tax is due on all equipment brought into this state used to perform construction if sales tax has not been paid. The use tax is based on the fair rental value of such equipment if it is used in this state for a period not exceeding 180 days in any 12-month period. If the use exceeds six months, the use tax is based on the full market value of such equipment used here.

In addition, there are many public determinations (Washington Tax Decisions (WTDs)) that discuss

the taxability of various construction activities. The laws, rules, WTDs and other publications are available on our Internet home page (<http://dor.wa.gov>) and through our Telephone Information Center at 1-800-647-7706.

Requirement to obtain contractors' UBI numbers

All taxpayers must maintain a record of the Unified Business Identifier (UBI) account number of each contractor they hire to perform construction. For example, the law requires a general contractor to record the UBI number of all subcontractors. Taxpayers must keep record of the UBI numbers for at least five years. If a taxpayer fails to record the contractor's UBI number, the taxpayer will not be allowed to bid on a public works contract for two years. The taxpayer will also be subject to a penalty not to exceed \$250.

Laws and rules on construction activities

The taxability of performing construction activities within the state of Washington is discussed in the following laws and rules:

Revised Code of Washington references (RCW)

Number	Title
64.04.010	Conveyances and encumbrances to be by deed
64.04.030	Warranty deed - Form and effect
64.04.040	Bargain and sale deed - Form and effect
64.04.050	Quitclaim deed - Form and effect
82.04.030	"Person," "Company"
82.04.050	"Sales at Retail," "Retail Sales"
82.04.190	Consumer
82.04.390	Exemptions - Amounts Derived From Sales of Real Estate
82.12.010	Definitions

Washington Administrative Code references (WAC)

Number	Title
458-20-107	Selling Price — Advertised prices including sales tax
458-20-110	Freight and Delivery Charges
458-20-112	Value of Products
458-20-135	Extracting Natural Products
458-20-170	Constructing and Repairing of New or Existing Building or other Structures upon Real Property
458-20-17001	Government Contracting — Construction, Installation or Improvements to Government Real Property
458-20-171	Building, Repairing or Improving Streets, Roads, etc.
458-20-172	Clearing Land, Moving Earth, Cleaning, Fumigating, Razing or Moving Existing Buildings & Janitorial Services
458-20-178	Use Tax
458-20-190	Sales to and by the U.S., its Departments, Institutions and Instrumentalities— Sales to Foreign Governments
458-20-192	Indians – Indian Reservations
458-20-193	Inbound and Outbound Interstate Sales of Tangible Personal Property
458-20-194	Doing Business Inside and Outside the State
458-20-197	When Tax Liability Arises
458-20-199	Accounting Methods
458-20-211	Leases or Rentals of Tangible Property, Bailments
458-20-223	Persons Performing Contracts on the Basis of Time and Material, or Cost-Plus-Fixed-Fee



Services

Electronic Filing helps you get it right the first time

Electronic Filing is a free, user-friendly online alternative to old-fashioned paper returns.



E-file helps you avoid penalties due to mistakes by checking your return for accuracy and flagging potential errors or omissions for your review before you file. Once you are satisfied that your return is accurate, E-file calculates taxes due for you. E-file also lets you:

- » Customize your return to show only the tax-reporting lines you need
- » Access the latest tax laws and rules
- » Choose among several payment options
- » File returns for past periods
- » View and print previously filed E-file returns
- » Ask questions via a secure e-mail messaging environment
- » Let a tax preparer prepare the return for you but have you review it before you submit it
- » Upload data from your own accounting software or spreadsheets.

For more information, go to the Online Services section at <http://dor.wa.gov> or call 1-877-345-3353.

Telephone assistance

Telephone Information Center Toll Free — 1-800-647-7706

The Telephone Information Center offers a variety of personal and 24-hour automated services to both Touch Tone™ and rotary dial callers.

The center's taxpayer information specialists provide assistance in registering businesses, completing tax returns, and responding to general questions. Specialists are available to answer questions Monday through Friday, 7:30 a.m. to 5:00 p.m.

Persons who do not need to speak with a specialist may use the center's automated features to change an address, close an account,

clear a delinquent notice, or request a publication, tax form, or Master Application.

Fast Fax: Toll Free — 1-800-647-7706

Fast Fax, the Telephone Information Center's fax on demand service, provides 24-hour access to a variety of the Department's forms and publications. To receive a fax listing forms and publications available via Fast Fax, use code 500.

Written rulings

Taxpayer information specialists in the Department's Taxpayer Information and Education Section respond to written inquiries for tax information. Unlike oral advice, written advice is binding on the Department, providing the taxpayer's name and all pertinent facts are disclosed. Inquiries may be sent to:

Taxpayer Services
Washington State Department of Revenue
PO Box 47478
Olympia, Washington 98504-7478

Listserv

Join Listserv, the Department's e-mail distribution service. Sign up to receive tax information and updates electronically. Topics include:

- » Electronic filing
- » Excise taxes
- » Sales tax rates
- » Property tax newsletter
- » Unclaimed property

Sign up at: http://www.dor.wa.gov/Content/Contact/email/con_email_listserv_app.asp?listtype=excise.

Washington tax decisions — published determinations

The Department of Revenue's appellate division routinely hears and provides written decisions on appeals of excise tax assessments and petitions for refund. The decisions, referred to as determinations, are confidential. Only the taxpayer for whom it is written may rely on the information

contained in a determination. However, some determinations by the Appeals Division are published after information identifying the taxpayer is removed.

Published determinations have precedential value and may be relied upon by the Department and all taxpayers. When deciding whether to publish a determination, the Department considers whether:

- » The issue under appeal is a matter of first impression;
- » There has been a change in the statute or rules since a similar issue was decided;
- » There are distinguishable fact patterns between the current appeal and a previously published determination on a similar issue;
- » There is a recent court decision concerning the issue on appeal; and
- » The length of time since the last published determination was issued on a similar issue.

Published determinations are referred to as Washington Tax Decisions. The Department publishes Washington Tax Decisions annually in two parts. The decisions are available electronically using Taxpedia at <http://taxpedia.dor.wa.gov>.

Other services

Speakers' Bureau

The Speakers' Bureau program provides speakers on a variety of tax issues for businesses and organizations. To reserve a speaker, call the Speakers' Bureau Coordinator at (360) 705-6601.

Taxpayer Rights Advocate

The Department of Revenue's Taxpayer Rights Advocate provides assistance in understanding and accessing taxpayer rights in working with the Department of Revenue. You can contact the advocate at (360) 705-6714.

Retainage fees

For release of retainage fees on completed public construction projects, call the Audit Division at (360) 725-7588.

Tax appeal questions

For all questions related to appeals with the Department, call the Appeals Division at (360) 570-6140.

Unclaimed property

For information on abandoned wages, stock dividends and deposits, please call 1-800-435-2429 or (360) 705-6706.

Internet

Internet users can access Washington State tax information via the Department of Revenue's web site. Users can access newsletters, fact sheets, brochures, forms, press releases, rules and laws, published determinations, state business records and unclaimed property databases, research reports, and more.

Site	Address	Comments
Department of Revenue	http://dor.wa.gov	
Employment Security Department	http://www.wa.gov/esd	For state unemployment tax information
Department of Labor and Industries	http://www.wa.gov/lni	For industrial insurance tax information
Department of Licensing	http://dol.wa.gov	For general business licensing information
Office of the Secretary of State	http://www.secstate.wa.gov	For information about corporations, trademarks, and limited partnerships
Access Washington	http://access.wa.gov/	For a master index of state resources



<http://dor.wa.gov>

