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A T T O R N E Y S

**PROFESSIONAL SERVICES,
RETAIL SALES TAX
AND IPD PROJECTS:**

**What You Need to Know before the Department
of Revenue Comes Knocking**

By

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A PROFESSIONAL SERVICE CORPORATION

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I. INTRODUCTION

Integrated Project Delivery (IPD) is all the buzz in the design and construction industry. As with any new approach to doing business, it is important to understand the potential advantages and disadvantages when assessing whether IPD is appropriate for your firm and your clients. One issue to include in this analysis is the potential for design, contract administration and construction management fees to become subject to retail sales tax as a result of the design professional's increased involvement in and responsibility for construction activities under an IPD contract. This white paper explores the ways in which the integration of traditionally distinct project responsibilities might affect how professional services are taxed by the Department of Revenue; provides an overview of the relevant statutory provisions governing the taxation of contracts for construction and professional services; and offers guidance to design professionals in determining whether sales tax must be collected on hybrid contracts that encompass both design and construction management services.

A. The Significance of Construction Projects to State Revenues, Economic Activity and Tax Enforcement

The retail sales tax is a primary revenue source for Washington State, accounting for approximately 50 percent of general fund deposits. The decline in taxable economic activity brought about by the recent Great Recession led to a shortfall in state revenue at a time of increased need for state services. In response, the state legislature enacted a host of budget cuts and revenue enhancements to address the severe budget crisis. One of those revenue measures granted the Washington State Department of Revenue (DOR) additional resources with which to conduct audits and improve compliance with existing tax laws.¹

In a related effort to boost state coffers, the DOR instituted its first statewide business tax amnesty program earlier this year. From February 1 through April 30, 2011, the DOR allowed businesses to pay back taxes without penalty or interest. Nearly 8,900 businesses participated in the program. The program generated an astounding \$343 million, more than ten times the DOR's initial estimate, and proved to be the second most successful amnesty effort in the

nation.² Prior to the start of the tax amnesty program, the DOR estimated that there were 50,000 delinquent businesses in the state.³ Hence, audits to improve compliance with tax laws are sure to continue, aided by the increased funding earmarked for this task.

The construction industry is a likely target of the DOR's ongoing enforcement efforts for two reasons. First, the state's revenue is very dependent on construction activity. Although construction makes up only about 4 percent of the state's economy, it accounts for 8 percent of the revenue in most years.⁴ Second, compared with other industries, the construction industry has one of the worst tax compliance records. According to the DOR's 2008 compliance study, the industry's overall noncompliance is estimated to account for nearly 14.5 percent of the state's total noncompliance.⁵ The construction industry, therefore, presents the possibility of producing substantial collection increases for the DOR. Architecture, engineering and other professional service providers linked to construction may become subject to heightened scrutiny, simply by virtue of their association with construction activities.

B. Integrated Project Delivery in a Nutshell

IPD is a relatively new approach to project delivery that calls upon all participants to collaborate throughout all phases of design and construction, thereby seeking to reduce waste and improve efficiency through integration. Collaboration between designers and constructors on an IPD project is intended to improve the parties' ability to:

- design to budget,
- reduce the need for contingency funds,
- exercise continuous quality improvement,
- minimize wasteful re-design,
- minimize the risks of errors and omissions resulting from a lack of understanding of practical difficulties in the construction phase,
- anticipate sequencing issues, and
- ensure that construction professionals understand the rationale underlying the design, thereby increasing functionality of the finished project.

In short, IPD seeks to foster a stronger nexus between design and construction and to eliminate the compartmentalization that is often blamed for project inefficiencies. However, as design professionals become more involved in the construction phase and assume more construction-related tasks, the boundary between professional services and construction becomes more porous, leading to a greater potential for professional services to become subject to the retail sales tax.

II. TAXES ON SERVICES PROVIDED BY DESIGN PROFESSIONALS

Ordinarily, construction activities and related services are taxable as retail sales and are also subject to the retailing business and occupation (B&O) tax, while consulting and engineering services are subject only to the B&O tax. The relevant tax rates in effect at the time of publication (September 2011) are:

0.471%	Retailing B&O tax
1.5%	B&O tax for Service & Other Activities (engineering and architecture services fall into this catch-all)
7.0 - 9.5%	Retail sales tax (varies by geographic location within state)

Under the applicable tax structure in Washington, a company providing professional services is not required to collect retail sales tax or pay the retailing B&O tax but, rather, is taxed at the higher “service and other activities” B&O tax rate on its gross income.⁶ Given the substantial difference between the applicable tax rates for services and retail sales, the proper classification can have a significant impact on a project owner’s bottom line.

A. A Primer on Retail Sales Tax and the Expansive Definition of “Retail Sale”

Sales tax is assessed on all retail sales. Initially, the term “retail sale” meant sales of tangible things. Over the years, however, the legislature has expanded the definition of “retail sale” to bring within its ambit an increasingly broad range of commercial transactions.⁷ Among other things, RCW 82.04.050(2)(b) imposes retail sales tax on labor and services rendered in respect to “[t]he constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers . . . and also includes the

sale of services or charges made for the clearing of land and the moving of earth.” Thus, “services rendered in respect to” constructing are retail sales.

In 1999, the Washington State Legislature enacted legislation -- RCW 82.04.051 -- to clarify the definition of the statutory term “services rendered in respect to” constructing. The clarification provides:

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

(2) A contract or agreement under which a person is responsible for both services that would otherwise be subject to tax as a service under RCW 82.04.290(2) and also constructing, building, repairing, improving, or decorating activities that would otherwise be subject to tax under another section of this chapter is subject to the tax that applies to the predominant activity under the contract or agreement.

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

(4) 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 (emphasis added).

The new statutory language codifies, but does not represent a change to, the DOR’s longstanding interpretation and application of the law.⁸ Subparagraph (1) explicitly requires consideration of both the nature of the services provided and the entity providing them. Thus, to be rendered in respect to constructing activities, (1) the services themselves must “directly relate

to the constructing” and (2) the provider of the services must be responsible for “the performance of the constructing.”⁹

Regarding the first part of the test, the DOR has emphasized that “the statute refers to the activity of ‘constructing,’ not construction in general. The use of this term sets up a requirement for a direct relationship to the actual building process.”¹⁰ As a general matter, “[t]he further removed an activity is from the physical activity of constructing a building, the less likely it is to be considered a service rendered in respect to that activity.”¹¹ At the other end of the spectrum, “when the relationship at issue involves a service that controls or determines how or when the constructing activity takes place, the service is directly related to building activity.”¹²

Regarding the second part of the test, which requires the entity providing the services to be responsible for the performance of the constructing, the relevant standard is set forth in the first and second sentences of RCW 82.04.051(4): the person must be “obligated to perform the activities either personally or through a third party,” and “[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.” This definition does *not* mean that only taxpayers legally obligated to perform the activities must collect sales tax. In fact, the DOR has specifically rejected a taxpayer’s argument that the definition “requires a taxpayer to be legally obligated to complete the physical construction itself (e.g., the general contractor) and not just be responsible for supervision or direction.”¹³ The DOR explained, “Were we to accept this argument, the second sentence would be unnecessary. Statutes are to be construed, wherever possible, so that ‘no clause, sentence or word shall be rendered superfluous, void, or insignificant.’”¹⁴

For the benefit of taxpayers seeking to interpret the term “services rendered in respect to constructing,” the legislature also published an accompanying statement of legislative findings and intent. That statement provides in pertinent part:

(1) The legislature finds that the taxation of "services rendered in respect to constructing buildings or other structures" has generally included the entire transaction for construction, including certain services provided directly to the consumer or owner rather than the person engaged in the performance of the constructing activity. Changes in business practices and recent administrative and

court decisions have confused the issue. It is the intent of the legislature to clarify which services, if standing alone and not part of the construction agreement, are taxed as retail or wholesale sales, and which services will continue to be taxed as a service.

(2) It is further the intent of the legislature to confirm that the entire price for the construction of a building or other structure for a consumer or owner continues to be a retail sale, even though some of the individual services reflected in the price, if provided alone, would be taxed as services and not as separate retail or wholesale sales.

(3) Therefore, the intent of this act is to maintain the application of the law and not to extend retail treatment to activities not previously treated as retail activities. Services that are otherwise subject to tax as a service under RCW 82.04.290(2), including but not limited to engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services, remain subject to tax as a service under RCW 82.04.290(2), if the person responsible for the performance of those services is not also responsible for the performance of the constructing, building, repairing, improving, or decorating activities.

Notes to RCW 82.04.051 (emphasis added). Additional evidence of legislative intent can be found in the bill summary provided in the House Bill Report, which confirms: “The services B&O rate (1.5 percent) applies to engineering, architectural, surveying, flagging, accounting, legal, consulting or administrative services when these services are sold to the construction industry.”¹⁵

The clarifying statute also mandates that hybrid contracts with both retail sales and service components are not to be segregated but, instead, are to be taxed according to the predominant activity under the contract.¹⁶ The DOR may combine and tax activities performed under two contracts, if the parties contemplated that the same person would be awarded both contracts. The authority to aggregate contracts means that a company may not circumvent the predominant activity test by entering into separate contracts for service and retail sale activities.

B. The Taxation of Construction Management Services

What happens when an architect or engineer not only provides design services but also gets involved in construction management? Over the years, this has been an exceedingly thorny question for the DOR. The Department’s website gives no indication of the complicated nature of this issue, however, but instead categorically pronounces all construction management services to be subject to retail sales tax:

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, when the provider of the services is responsible for the performance. 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.¹⁷

This sweeping characterization is potentially misleading, because the term “construction management” encompasses a broad range of activities, some of which may properly be treated as professional services, rather than retail sales, for taxing purposes. Indeed, in individual cases, the DOR has acknowledged that the line between professional services and retail sales is far from clear:

The precise delineation when professional services are rendered in respect to construction has presented a substantial challenge. The interpretation of the language in Rule 170 [WAC 458-20-170] and related statutes has been a much-contested point. A number of cases have visited the issue without producing an unequivocal test or standard to apply to the review of construction management services.¹⁸

The Board of Tax Appeals has similarly stated:

We agree . . . that there is no clear delineation that determines when work is performed in respect to constructing and when it is not. Department determinations have been made on a case-by-case basis. This Board has not developed its own bright-line test, nor are we able to do so in this appeal. The issue is complex and does not lend itself to a simple, widely applicable, easy-to-apply solution. We agree with the Department that it is the nature of the service provided, rather than the business of the client, that determines the applicable tax rate.¹⁹

Published tax decisions show that some construction management services are taxed as retail sales, while others are treated as professional services. Thus, the relevant question is whether the particular construction management services at issue constitute *retail* construction management activities.²⁰

The DOR has on occasion resolved the issue by comparing the nature of the services at issue to services performed by architects.²¹ For example, in one case, the DOR held that the retail sales tax did not apply where a taxpayer reviewed, inspected, advised and acted as a facilitator in promoting the client’s interests but did not direct or supervise any constructing activity. The DOR stated: “[T]he taxpayer’s role falls short of being a co-superintendent of

construction activities. The taxpayer's activities are in the nature of professional services, *such as provided by architects, inspectors, and consultants to project owners*, and are appropriately taxed as a service rather than a retail sale.”²² Thus, in considering whether construction management activities performed by a design professional constitute a sale or a service, it is appropriate to review the statutory definition of the relevant professional practice.

“Practice of architecture” means the rendering of services in connection with the art and science of building design for construction of any structure or grouping of structures and the use of space within and surrounding the structures or the design for construction of alterations or additions to the structures, including but not specifically limited to predesign services, schematic design, design development, preparation of construction contract documents, *and administration of the construction contract.*²³

“Practice of engineering” means any professional service or creative work requiring engineering education, training, and experience and the application of special knowledge of the mathematical, physical, and engineering sciences to such professional services or creative work as consultation, investigation, evaluation, planning, design, *and supervision of construction for the purpose of assuring compliance with specifications and design*, in connection with any public or private utilities, structures, buildings, machines, equipment, processes, works, or projects.²⁴

Both definitions make it clear that architects and engineers routinely review construction to determine whether the work complies with the design requirements. Insofar as the construction management tasks performed by a design professional fall within the statutorily recognized functions of an architect or engineer, they are more likely to be taxed as services, not retail sales.

C. Identifying the Predominant Activity under a Hybrid Contract for Both Professional Services and Services Rendered in Respect to Construction

The previous section posits that a design professional's contract expressly includes construction management services as part of its scope of work. In that case, determining the applicability of sales tax involves only one issue: whether those construction management activities are services rendered in respect to constructing. If so, the tax analysis ends there, and sales tax must be collected.

However, if the design professional is a party to a second contract relating to the same project, such as an IPD contract, then an additional analysis must be undertaken. In that case, there may be an independent basis for sales tax liability, even if the construction management

activities are deemed services, as opposed to sales. Specifically, the second contract may cause the design professional's services to be converted into sales "[i]f the services are functionally integrated with what is predominantly a retail activity."²⁵ This functional integration test may present hidden tax pitfalls for parties to an IPD contract, especially if such contracts create an organizational structure under which the design professional exercises supervision or direction over constructing activity.

The DOR has applied the functional integration test on a number of occasions, explaining:

[A] company that provides services, including professional services such as engineering or architectural services, under most circumstances, is not required to collect retail sales tax, but must pay tax at the higher "service and other activities" B&O tax rate on its gross income. RCW 82.04.290; WAC 458-20-224 (Rule 224). However, under certain circumstances a company must collect retail sales tax and pay retailing B&O tax for such services.

If the services are functionally integrated with what is predominately a retail activity, such as occurs under a contract to design and build a new structure, then the entire contract price is subject to tax. . . . If the design phase is bifurcated from the construction phase, and separate contracts are awarded to the same company, a factual inquiry is required to determine whether the two phases are functionally integrated.²⁶

Put differently, services that "are not directly related to constructing activity are subject to sales tax only if they are functionally integrated with the construction phase. This occurs when a taxpayer is hired by an owner to both develop and to build or manage a project. For example, when an agreement exists from a project's inception that a [taxpayer] would develop and construct or manage the project, retail sales tax is properly assessed on the developer's fee."²⁷

The functional integration test originated from the Washington Supreme Court case of *Chicago Bridge and Iron v. Dep't of Rev.*, 98 Wn.2d 814, 818, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983). In *Chicago Bridge*, the Court rejected an attempt by an out-of-state corporation to bifurcate contracts for design and manufacturing from contracts covering the installation of those products. The case involved the B&O tax, rather than the retail sales tax. At issue was whether the taxpayer's design and manufacturing contracts had a sufficient nexus to

Washington State to confer jurisdiction upon the DOR to impose the B&O tax. Chicago Bridge's business operations were described as follows:

CBI generally performs all aspects of design, manufacture, delivery and installation of its product, and customers negotiate a single, lump-sum price for a finished, installed product. CBI's engineering, manufacturing, and installation operations are functionally integrated and coordinated from the first proposal to a customer through each phase of the design, manufacturing and installation process. This integration is accomplished through frequent communications among the divisions and departments of the company.²⁸

The Court held that Chicago Bridge's design and engineering service contracts were subject to Washington's B&O tax, because the contracts were "functionally integrated."²⁹ The Court stated, "CBI's isolation, for taxing purposes, of its contracts for design and manufacturing from those for installation appears an exaltation of form over substance. . . . On several occasions the United States Supreme Court has recognized that a company's internal accounting techniques are not binding on a state for tax purposes."³⁰

In enacting the clarifying amendment at RCW 82.04.051(2) in 1999, the Washington State Legislature added a further gloss to the analysis in articulating the "predominant activity" test as the criteria for determining whether professional services are taxable as retail sales. When a contract covers both professional services and services rendered in respect to construction, the tax consequences for the contract as a whole is determined by looking to the predominant activity under the contract. The term "predominant activity" is not defined in the statute, however. Words that are not statutorily defined must, whenever possible, be given their ordinary and usual meaning.³¹ The DOR has recognized that "[u]nder common usage, the term 'predominant is not defined solely in quantitative terms. It means, among other things, as having 'greatest ascendancy, importance, influence, authority, or force.'³² Thus, "[i]n identifying the predominate activity we must look to the activities of greatest importance in relation to the business being conducted."³³

The DOR illustrated this proposition by citing a 1953 Washington Supreme Court case involving a "hotel" where both legitimate and illegitimate activity occurred. In that case – *State ex rel Carroll v. Gatter*, 43 Wn.2d 153, 260 P.2d 360 (1953) – the Court was called upon to

identify whether the legitimate or illegitimate activity was the predominant activity at the “hotel.” The case did not arise under the tax statute but, rather, under a “Red Light Statute” that was “directed to the abatement of commercial eroticism.”³⁴ The Court reasoned that “showing mathematically that the principal business of the establishment is legitimate” would not identify the predominant activity, because “[t]he legitimate and the illegitimate activities occurring on the premises may be so intermingled that the lessor activity is predominant and controls the determination that the premises are, or are not, houses of lewdness, assignation or prostitution.”³⁵ One wonders whether the Court’s discussion in that case was tailored to justify its desired outcome.

In any event, the case illustrates the flexibility and breadth of the predominant activity test. It provides a basis for design professionals to argue that professional services constitute the predominant activity under a teaming agreement and, therefore, any design and non-retail construction management services should not be deemed “functionally integrated” with constructing activity. Ultimately, when design or other professional services are intertwined with the performance of construction, the proper measure of tax will “turn[] on to what degree the respective [design professionals] were involved in the actual construction. The Department of Revenue has held that when the relationship between service and actual construction is so directly related as to control or determine the nature of the actual construction, the activity is subject to retail sales tax.”³⁶ In the IPD context, the relevant question is whether the design professional’s predominant activity under the IPD contract involves supervision or direction of constructing activity. If so, and if the design activity was functionally integrated with the supervision of the constructing activity, then sales tax may be imposed on the total fee for all of the designer’s services.

III. ANALYZING STANDARD AND IPD CONTRACTS: HOW DIFFERENT FORMS OF AGREEMENT MAY TRIGGER THE APPLICATION OF RETAIL SALES TAX.

Because Washington’s retail sales tax is significant, design professionals and other professional service providers should understand the sales tax consequences of different

contractual arrangements, particularly those seeking to tighten the relationship of each individual party to the construction activity, such as IPD contracts. There are certainly ways in which a project as a whole can benefit when the design professional plays an integral role in constructing a structure. However, along with the increased level of involvement assumed by design professionals under collaborative contracts comes the potential to incur an additional tax burden. In this section, we will consider the risks attendant to different contractual arrangements between owner and designer, including a standard form of agreement, an “IPD-ish Agreement,” a pure IPD multi-party agreement and a pure IPD agreement for a single purpose entity.

A. Standard Forms of Agreement between Owner and Designer

1. Design Services.

In the Standard form of Agreement between Owner and Designer, such as the AIA B101 or the ConsensusDocs B240, the owner and designer are the only parties to the Agreement. As long as the designer’s scope is limited to design work during the design phase, sales tax does not apply. As previously explained, RCW 82.04.051(1) and the accompanying interpretive notes make clear that the legislature had no intent to extend retail treatment to activities not previously treated as retail activities, including engineering, architectural, surveying, flagging, accounting, legal, consulting or administrative services, if the person responsible for those services is not also responsible for the performance of constructing, building, or improving activities. It has always been the case that “[p]ure engineering services are subject to Service B&O tax.”³⁷

2. Design Services Plus Contract Administration Services.

As for work performed in the construction phase, the inclusion of certain limited contract administration services in a design professional’s contract will not convert that contract from one for professional services to one for construction for taxing purposes. The DOR has agreed that an architecture or engineering (“A/E”) firm’s activities should still be treated as services, if the scope of post-design work is consistent with the definition of the practice of architecture as set forth in the Revised Code of Washington and in the American Institute of Architects’ standard forms. A few cases provide examples of the application of these definitions.

In one case, the DOR held that a company providing both architectural services and limited construction consultation for a restroom upgrade was not required to collect retail sales tax, because the services rendered fell within the scope of activities identified in the statutory definition of the practice of architecture at RCW 08.08.320(1).³⁸ Under that statute, the practice of architecture includes “schematic design, design development, interpretation of construction contract documents *and administration of the construction contract.*”³⁹ Characterizing the degree to which the architects were involved in actual construction as “de minimis,” the DOR reasoned:

Although the services provided by the respective architectural firms were related to the general process of construction and consultation regarding such construction, neither activity appears to be sufficiently related to the actual act of constructing a new or existing facility to warrant the imposition of the retail sales tax. The services rendered were in the nature of professional services, well within the services provided by architects in general. . . . Accordingly, we find the services purchased are not subject to retail sales tax, but rather service B&O tax.⁴⁰

In another case involving an architect, the DOR was asked to decide whether “an architect’s services constitute services in respect to constructing when it provides contract administration services during construction?”⁴¹ The DOR held that such contract administration services were not subject to sales tax, relying in part on language contained in two standard form agreements published by the American Institute of Architects (AIA): Standard Form Agreement Between Owner and Architect for Housing Services (AIA Form B181 (1978)) and Standard Form of Agreement between Owner and Architect (AIA Form B141 (1987)). Both form agreements provided for contract administration during the construction phase. In that case, the taxpayer stated that his “involvement in the construction phase was strictly limited to exercising his professional judgment as to whether the construction work meets the requirements of the architectural documents he had prepared.”⁴² The DOR noted that AIA Form B141 defined construction administration services to include site visits “to determine in general if the Work is being performed in a manner indicating that the Work when completed will be in accordance with the Contract Documents . . . to evaluate Contractor’s Application for Payment; as well as the authority to reject work which does not conform to the Contract Documents, to prepare for

the owner's approval Change Orders and Construction Change Directives and to conduct inspections to determine the date or dates of Substantial Completion." The DOR also noted that a separate AIA standard contract exists for construction management services.⁴³ Based on these factors, the DOR concluded:

In contrast to construction management services, an architect who contracts to design a building and who also provides contract administration services would not be providing service in respect to constructing the building. Although the architect is administering the contract for the owner, such services are significantly removed from the actual construction--the architect does not control or direct how or when the building activity takes place.

In this case, we find that the taxpayer did not supervise or manage the construction projects, and he did not direct or control how or when any constructing activity took place. He did not keep the projects on schedule by monitoring construction schedules. He also did not supervise or manage any of the construction activity itself. Rather, his services were in the nature of professional services, such as are commonly provided by architects. Although his services were related to the general process of construction in that the taxpayer administered the contract during construction and consulted with owners about the construction, the activities did not directly relate to the physical activity of constructing itself. Accordingly, the services are not services in respect to constructing activity.⁴⁴

These cases indicate that a design professional may provide contract administration services to an owner without necessarily triggering sales tax consequences.

3. Design Services Plus Construction Management Services.

The tax consequences can change significantly when the design professional's duties extend to keeping projects on schedule or other forms of supervision or management of construction projects. In those circumstances, as illustrated in the examples below, the DOR can tax *the full amount of the fees collected*, including those solely related to design. In a petition for refund filed by a civil engineering firm, the DOR opined that the firm's services generally appeared to be rendered in respect to constructing, and therefore the firm would be required to collect sales tax from the consumer or be personally liable for the sales tax.⁴⁵

In this case, the taxpayer reports that his firm does the design work, oversees the construction project as consultant, prepares change orders, makes daily construction inspections, tests construction materials, and furnishes a full-time resident construction manager. We conclude that these service activities when in addition to merely design work are "rendered in respect to constructing".⁴⁶

However, because there was insufficient evidence as to the specific activities the firm performed under the particular contracts at issue, the DOR referred the matter to a field auditor to determine whether the firm's engineering services under the contracts involved only design work or whether there were additional services that would compel the conclusion that the engineering services were rendered in respect to construction and, thus, taxable as retail sales.⁴⁷

There are few reported cases in which engineers or architects have challenged the assessment of sales tax on construction management activities. To find substantive guidance as to what types of construction management activities constitute services rendered in respect to construction, it is helpful to examine cases involving taxpayers who are not designers, but rather project consultants, developers and other professionals. The cases summarized below show that administrative facilitative functions are sometimes denominated "construction management services" and the nature of the services must be scrutinized on a case-by-case basis.

Case No. 1 (Retail Sale)

In *Steele v. Dep't of Rev.*, No. 47590 (Bd. of Tax Appeals 1996), the Board of Tax Appeals held that construction management services were subject to retail sales tax where such services consisted of the following: dealing directly with contractors and suppliers to obtain bid proposals; preparing, monitoring and continuously updating the construction schedule; purchasing materials; checking materials for quality; determining whether the contractor's work was up to standards; and authorizing payment and turning invoices over to the owner for payment. The taxpayers supervised construction on a day-to-day basis, purchased materials, and kept the construction on schedule. The DOR summarily rejected the taxpayers' contention that they lacked authority to supervise contractors, stating "this is true if one considers the term 'supervise' to mean the authority to direct the contractor as to the means and method of accomplishing the job."⁴⁸ The DOR regarded as inconsequential the fact that the contractor controlled the means and methods of construction and, instead, ascribed greater significance to the fact that the taxpayers owed a "responsibility to the owner to determine whether the work complie[d] with contract specifications."⁴⁹ This compliance assurance activity was held to

concern how and when the construction activity took place and, accordingly, was deemed directly related to the activity of constructing a building or structure. Taken as a whole, the taxpayers' activities "encompass the classic construction management function without which no building more complex than an unheated chicken coop could be built on time and within budget."⁵⁰

Case No. 2 (Retail Sale)

The taxpayer provided construction services to consumer who asked for guidance through the acquisition and remodeling of office space.⁵¹ The taxpayer provided design assistance, prepared job cost estimates, navigated the permit process, served as job supervisor and manager of certain construction activities, and acted as liaison between the client and contractors. The client acted as its own general contractor. With very little analysis, the DOR concluded that the taxpayer's services fit the definition of a retail sale, because they were rendered in respect to construction of a structure.

Case No. 3 (Retail Sale)

The taxpayer was a general contractor that provided contract management and construction management services under two contracts.⁵² The taxpayer essentially controlled the project for the owner.

In the design phase, the taxpayer agreed to provide services for consultation during project development, scheduling, project construction budget, coordination of contract documents, and construction planning. In the construction phase, the taxpayer agreed to provide services for project control (including monitoring work, maintaining a competent full-time staff at the project site for coordination and general direction, progress meetings with contractors, and determination of the adequacy of contractors' personnel and materials), provision of facilities, cost control, change orders, payments to contractors, permits and fees, owner's consultants, review of work and safety, document interpretation, shop drawings and samples, reports and project site documents, determination of substantial completion, final completion and delivery of warranties to the owner. The taxpayer also agreed to provide, for example, services related to investigation, appraisals or valuations of existing conditions, facilities or equipment, services for tenant or rental spaces, services related to construction performed by the owner, services made necessary by a contractor's default, etc.⁵³

The DOR summarily held that the taxpayer's services came within the broad definition of "services in respect to construction" because its construction management services were "plainly related to actual construction activities."⁵⁴

Case No. 4 (Not Retail Sale)

The taxpayer was a construction consultant who provided assistance to homeowners so that they could act as their own general contractor or construction manager.⁵⁵ The taxpayer provided owners with a handbook, consulted with owners during construction, reviewed contractors' bids with the owners, and made visits to the site. The DOR noted that the taxpayer did not deal with subcontractors or material suppliers, keep the project on schedule, or supervise or manage the construction activity itself. The taxpayer merely educated and consulted with owners about construction, and its activities did not relate directly to the physical activity of constructing. The DOR concluded that these consulting activities were not services in respect to constructing.

Case No. 5 (Not Retail Sale)

The taxpayer served as the owner's representative on a large scale construction project that had to be completed on a compressed schedule.⁵⁶ The taxpayer's function was to provide an independent assessment of the project and the work performed. Other key project personnel included the site superintendent and construction foreman, both employed by the general contractor, and an architect's representative, who was on-site full time. The architect's representative could have provided the services the taxpayer provided, but it was more cost-effective for the client to hire the taxpayer to act as an objective third party to assure the timely completion of the project. The taxpayer "served as a conduit for information and facilitated an organized process for the project."⁵⁷ It provided oversight and monitored projects, but did not manage, direct or control the contractor's activities. The taxpayer reviewed and analyzed contractor change requests, but had authority to approve changes only if they were immaterial.⁵⁸ Even though the taxpayer's contract called for him to "direct and coordinate the work of the contractor," the owner clarified that this language was a boilerplate provision lifted from prior

construction management contracts and did not accurately represent the taxpayer's actual role or authority, which "did not entail the direction or management of the actual construction process or actual building activities."⁵⁹ There was extensive evidence of the parties' intent to convey more limited authority to the taxpayer. Based on the weight of the evidence, the DOR concluded that "nothing in the contract renders the taxpayer responsible for the performance of the 'constructing' work. While the taxpayer's construction management services did relate generally to the construction process and were likely of great importance, we find that the taxpayer did not directly control or direct the actual constructing."⁶⁰ The DOR articulated its reasoning as follows:

Neither the taxpayer nor the School District intended the taxpayer to have the authority to direct any constructing; the taxpayer's compensation was based on an hourly pay rate and was not tied to the construction costs; the taxpayer was not the general contractor on the project; there was a general contractor who had its own contract with the School District and who had a separate supervisor on site; the general contractor's supervisor controlled and directed the actual constructing activities; the taxpayer's services were characterized by both the taxpayer and the School District as similar to those traditionally provided by architects and engineers; and the parties intended that the taxpayer serve primarily as a conduit for information, assimilating and organizing information from those doing the building to enable timely inspection and progress.

The facts support the taxpayer's contention that regardless of certain boilerplate contract language the intention and action of the parties was that taxpayer provide only records management, review, analysis, coordination of information pertaining to the project's progress. . . . The taxpayer did engage in activities that were classified as supervisory, but did not directly supervise the constructing work. Rather, the taxpayer provided the administrative framework that enabled and supported that constructing work.

The taxpayer's efforts unquestionably facilitated and expedited the construction process, but the vital distinction is that the taxpayer's services did not directly relate, direct or control, the physical building activities but rather related to the administrative, regulatory, bookkeeping, and organizational details that arose from actual constructing activities. Based on the foregoing information, we find that the taxpayer's services . . . were not directly related to constructing.⁶¹

Case No. 6 (Not Retail Sale)

The taxpayer provided project management services to tenants seeking to construct and improve commercial office space.⁶² The taxpayer acted as the client's representative to ensure the construction was done correctly, on time and at a reasonable cost. In general, the taxpayer

assisted in space planning and development of tenant improvement specifications; was responsible for design and construction time frames and completion of all necessary documents to keep build-out on schedule; conducted the competitive bid process; analyzed bids; recommended contractors; assisted in negotiating final contract; assisted with permitting process; reviewed and validated contractor invoices; and monitored construction. The taxpayer characterized its role as follows:

The taxpayer states it acts as a monitor, auditor, mediator, conciliator, and expert advisor. It does not do any of the constructing. It does not decide “constructability” issues. It does not supervise the means and methods of construction. It does not order material. It does not hire anyone. It is not responsible for any of the construction. If it were not present, the job would be done anyway. But, it is less likely the job would be done timely or to the tenant’s satisfaction. It is common for a commercial tenant to hire an expert to look after their interests, and if they did not hire the taxpayer, the clients likely would hire an architect or other expert advisor.

...
[Taxpayer] provides input on how to handle the situation when the work has gotten off schedule.

...
[Taxpayer] does not supervise the manner and methods of construction. It inspects the work after it is done, and tells the contractors when it believes the work is not in accordance with the requirements of the contract or otherwise is deficient from the tenant’s perspective.⁶³

After evaluating the context, the DOR concluded that the taxpayer was providing professional consulting services and not services in respect to constructing. Of particular significance was the fact that “[t]he taxpayer provide[d] services in situations in which there is a separate general contractor and construction supervisor.”⁶⁴ The DOR elaborated:

The essence of the taxpayer’s role is review, inspection, advising the tenant, and acting as a facilitator in promoting the tenant’s interests. It provides no “hands on” work, makes no decisions as to the subcontractors and suppliers, and does not warrant any of the work. The taxpayer does not arrange for the provision of construction services, or direct or supervise the constructing activity itself.

The taxpayer’s presence, and its activities, certainly affect how and when the constructing activity takes place. Its involvement assures that the parties are in frequent communication, and potential problems are promptly aired and resolved. But the taxpayer does not control or determine how and when the building activity takes place. It does not supervise or direct the work of the general contractor or subcontractors. It is not responsible for the performance of the constructing activity. Based upon its description of its activities, even on projects on which the tenant contracts with the general contractor, the taxpayer’s role falls short of being a co-superintendent of construction activities. The taxpayer’s

activities are in the nature of professional services, such as provided by architects, inspectors, and consultants to project owners, and are appropriately taxed as a service rather than a retail sale.⁶⁵

It is difficult to reconcile this outcome with that reached by the Board of Tax Appeals in *Steele*, the seminal case on this matter, where the taxpayer was responsible for many of the same types of activities. The two decisions suggest that whether construction management activities are services or sales depends, at least to some extent, on whether the DOR can identify another project participant with more hands-on management duties. In *Steele*, the taxpayer was essentially filling the role of a prime contractor for homeowners, who acted as their own contractor; there was no one else who coordinated the constructing activities. Here, in contrast, the taxpayer served as an additional reviewer on a project that was already staffed with supervisory personnel.

B. Overlay/Teaming Agreement (IPD-ish Agreement)

Teaming agreements bridge the middle ground between traditional contracts, as just discussed, and non-traditional agreements utilized in IPD. Many owners and project teams are still unwilling to take the plunge into a pure IPD agreement (including shared compensation structures and an agreement to waive claims against each other). Supplementary “overlay” or “teaming agreements” allow the owner to execute separate agreements with the designer for design services and with the contractor for construction services. Those agreements can include typical contract terms for construction and design, such as liability allocation clauses, or can be limited to describing the basic scope of the architect or contractor, leaving more specific provisions for inclusion in the teaming agreement.

The teaming agreement is a document that is then signed by each of the three parties and, in its most basic form, expresses the parties’ intention to work collaboratively to achieve the owner’s program and project success. In its most complex, IPD-ish form, the teaming agreement may create project management teams with representatives from each of the three entities, incorporate a milestone schedule to which compensation is tied, and create contingency funds or incentive pools through which the parties will be rewarded if they achieve success on the project.

A teaming agreement promotes collaboration among the design and construction entities working on the project. There are many touted benefits to collaboration, even without the added IPD elements of shared risk and reward, or “safe harbor” decision making. Contractor involvement during the design phase can assist the designer in understanding constructability issues, whether it be sequencing of construction, suitability or availability of materials, or expenses associated with certain methods of construction. It may also result in a more “complete” design before construction begins, reducing changes to the design during construction, when changes are more costly. The more complete design may also reduce the amount of contingency funds to be set aside during the construction phase, because the collaboration between designer and contractor may have brought constructability and design issues to the forefront to be worked out during the design phase.

Teaming agreements can span the length of the project, or can start at the conclusion of the design phase and before construction. Entering into a teaming agreement for the entire length of the project and requiring the design team to provide services beyond contract administration increases the risk that the design team will be subject to retail sales tax on the design services provided for the project, because it potentially ties the design team to the act of constructing.

The DOR has explained that “most architectural, administration, inspection, or other related services--which may be related to the general process of construction--are not directly related to the activity of constructing itself. Accordingly, they would not be covered, *except when they are functionally integrated with a building or installation activity.*”⁶⁶ If services are functionally integrated with constructing, then the entire contract price is subject to sales tax.⁶⁷ With an IPD teaming agreement, it is necessary to ask: Does the teaming agreement cause the design and/or contract administration services to become functionally integrated with the building activity, such that retail sales tax must be collected on the A/E firm’s fees? This is an untested area and the outcome likely hinges on how the teaming agreement is written. If the teaming agreement merely expresses the parties’ intent to collaborate, establishes open channels

of communication and outlines processes to facilitate smooth project performance, it may not change the tax consequences for the design professional. If, however, the teaming agreement creates interdisciplinary project management teams that do more than review the construction and are, in fact, responsible for controlling how and when constructing takes place, the agreement may well trigger the assessment of sales tax on the design professional's services that would not be subject to taxation if standing alone.

C. IPD Agreement using a Multi-Party Contract

Multi-party IPD agreements differ from traditional contracts in several important ways, the most significant being that the owner, design professional and contractor all become parties to one agreement, called a “multi-party” or “tri-party” agreement.

There are several boilerplate contracts available for use or reference on integrated projects, including the AIA Multi-Party C191 Agreement, and the ConsensusDocs 300 Tri-Party Agreement. Each of these agreements incorporates the tenets of “pure IPD.” Pure IPD agreements create the following conditions, intended to serve the best interest of the project by fostering collaboration and integration:

- The designer and contractor are hired and begin working together early in the project, ideally before conceptual design, through the completion of construction.
- Project management teams are created, which include representatives of each of the entities to the agreement.
- A compensation structure is developed, which provides incentive compensation upon the successful achievement of project milestones and/or project completion.
- The parties agree to waive the ability to make (certain) claims against each other relating to performance under the agreement.

Multi-party agreements, like teaming agreements, typically contain a statement of the intent of the parties. The AIA 295, for example, states:⁶⁸

Owner, Architect and Contractor have agreed to plan, design and construct the Project in a collaborative environment following the principles of Integrated Project Delivery and to utilize Building Information Modeling to maximize the use of their knowledge, skills and services for the benefit of the Project. The Architect and Contractor will deliver the Project in the following phases, which may overlap: Conceptualization, Criteria Design, Detailed Design, Implementation and Construction and Closeout.

§ 1.1. The ConsensusDocs Tri-Party Agreement states:

The Parties agree that the Project objectives can be best achieved through a relational contract that promotes and facilitates strategic planning, design, construction and commissioning of the project, through the principles of collaboration and lean project delivery. This approach recognizes that each Party's success is tied directly to the success of all other members of the Collaborative Project Team and encourages and requires the Parties to organize and integrate their respective roles, responsibilities and expertise, to identify and align their respective expectations and objectives, to commit to open communications, transparent decision-making, proactive and non-adversarial interaction, problem-solving, the sharing of ideas, to continuously seek to improve the Project planning, design, and construction processes, and to share both the risks and rewards associated with achieving the Project objectives. . . . The Parties shall perform as a Collaborative Project Delivery (CPD) Team to facilitate the design, construction and commissioning of the Project.

§ 3.2, 3.3. These statements express the designer's intent to be integrally involved in the project during the construction phase.

Other provisions of these agreements also link the designer to the construction of the project. The AIA 295 requires the designer to "advise and consult with the Owner during the Construction Phase" of the project. § 9.26.1. It requires the contractor to submit monthly reports to the designer such that the designer can review the progress of the project. § 3.3.2; § 9.3.2. It is up to the designer to investigate unknown conditions encountered at the site and approve any request for additional compensation by the contractor, as well as to review and approve periodic construction schedules prepared by the contractor. § 9.7.4; § 9.10.2. *See also* § 9.26.4.1 (designer's duty to visit the site to observe progress); § 9.26.4.2 (designer's authority to reject work), § 9.26.5.1 (designer's duty to review submittals); § 9.26.5.4 (designer's duty to respond to RFI's during construction); and § 10.8.1 (designer's duty to review facility operations and performance at end of warranty period).

The ConsensusDocs 300 Agreement creates a management group, including the designer, owner and contractor, which is generally responsible for delivery of the project through substantial completion:

The delivery of the Project shall be managed by the Management Group, which shall serve as the decision-making body for the delivery of the Project and shall employ collaborative methods for achieving the highest quality and most efficient and economical delivery of the Project.

§ 4.1. It requires the actions and decisions of the management group to be made by consensus, to the greatest extent possible. § 4.6. The management group is also responsible for developing a preconstruction site investigation plan and recommending additional investigations or information reasonably required to prepare the construction documents. § 5.1. The management group is responsible for specifying all applicable performance and design criteria for any work performed on a design-build basis, and must meet weekly during the preconstruction phase to “facilitate collaboration regarding all project elements, including site use and improvements, the selection of materials, building systems, and equipment.” § 6.7; § 6.12. The designer is explicitly required to provide construction administration through final payment, and must monitor the progress and quality of the work on site during construction. § 14.1-14.2.

IPD agreements inextricably link the designer to the performance of construction. In both of the agreements described above, the designer’s participation in the management group could be interpreted as a duty to supervise the construction of the project, thus creating a risk that the design professional’s fees may be subject to sales tax. (Interestingly, the AIA C295 Agreement addresses sales tax applicable to the contractor’s work, but not applicable to the design professional’s fees. § 9.6.) Given the clear intent to functionally integrate the design professional into the construction phase of the project, it is unlikely that the use of exculpatory clauses attempting to exempt the design professional’s work from sales tax would be effective in this context. It is difficult to envision circumstances under which the DOR would find the designer to be integrated with the management team for project delivery purposes, yet not integrated for taxation purposes.

D. IPD Agreement for Single Purpose Entity

Another contractual mechanism used by some owners and project teams in IPD involves the formation of single purpose entities or companies, instead of using a multi-party agreement. The AIA C195 Agreement is an example of such a contract. In this contractual arrangement, each entity, including at a minimum the owner, designer and contractor, becomes a “member” of the company. The purpose of the company is to construct and deliver a project “in a

collaborative environment, following the principles of Integrated Project Delivery.” § 1.2.1.

The company is then “required to furnish the planning, design, construction, and commissioning of the Project” through separate agreements with the designer, construction manager, other non-owner members and non-member consultants and contractors. §§ 6.1.1-6.1.5. Simply put, the company executes a standard contract for performance of design services with the designer, and with the contractor for construction services.

There are three ways in which a design professional could be required to collect sales tax in this scenario. First, the C195 Agreement requires the company to contract with the designer for “planning, design, construction contract administration and other services as are necessary to deliver the Project.” The scope of services in the contract will dictate whether such services are subject to sales tax. As previously explained, although design professionals may avoid collecting sales tax where their contracts involve some administrative services not directly related to construction, sales tax will be imposed if the designer’s most significant, important or predominant activities involve the supervision or direction of the constructing activity.

Second, the DOR could aggregate the designer’s contract for design services with the IPD contract creating the single purpose entity and conclude that the predominant activity is construction. All professional services – both design and construction administration – could be viewed as being functionally integrated with the activity of constructing and, therefore, taxable. The law does not countenance the execution of two separate contracts – the first, for planning and design, and the second for construction administration during the construction phase of the project – in order to avoid paying sales tax on the fees collected for the design services. RCW 82.04.050(4). “If the design phase is bifurcated from the construction phase, and separate contracts are awarded to the same company, a factual inquiry is required to determine whether the two phases are functionally integrated.”⁶⁹ Thus, while forming a single purpose entity is one way to deliver an integrated project, it is not a contractual means to shield the designer from being taxed at the retail sales rate for its services on such a project.⁷⁰

Third, the design professional is at risk of liability for sales tax because under the single purpose entity IPD approach, the team members form a joint venture. Each member of the joint venture faces the risk that it is jointly and severally liable for everything – including taxes, penalties and interest – chargeable to the joint venture.⁷¹ The DOR has held that tax consequences applicable to joint ventures are proper when: “(1) the joint venture was specifically formed to perform the contract work, (2) the formation of the joint venture occurred before any of the work required by the contract had been undertaken, (3) the contract work was in fact performed by the joint venture, (4) the funds were handled as a joint venture rather than as separate funds of any party to the joint venture agreement, and (5) there is a contribution of money, property and/or labor so that any profit or loss incurred by the joint venture is proportionately shared by all joint venturers.”⁷²

IPD contracts may contain provisions allocating the responsibility for sales tax to one or more parties. However, the contracting parties should be aware that any such provision is not binding upon the DOR. In the event additional taxes are assessed against a taxpayer, the DOR is statutorily authorized to proceed against the seller, as well as the buyer of services.⁷³ Thus, design professionals could incur substantial transactional costs in dealing with the DOR, even if they successfully manage to resolve issues of ultimate liability with their team members at a later date. For example, under the tax statute, any taxpayer seeking to file an action in court to contest an excise tax, penalty or interest must first *pay the tax in full* as a jurisdictional prerequisite to judicial review.⁷⁴ This is an onerous responsibility for any taxpayer to bear, even if indemnification is given by other members of an IPD project team.

In 1986, the Board of Tax Appeals (BTA) considered an appeal involving the assessment of sales tax on professional engineering services performed by the Morrison-Knudsen Company for the Washington Water Power Company (WWP) in connection with the construction of a power plant.⁷⁵ Morrison-Knudsen was hired to design, procure and construct the power plant. Morrison-Knudsen used what it called its “prime manager concept,” the key attributes of which were summarized as follows:

M-K's Prime Manager concept *places all design/construction responsibility within a single management team*. As pieces of the design are completed, procurement and/or construction can begin. The construction plant and facilities and the construction equipment spread are executed by one entity for the complete plant. This reduces overlap and duplication of resources.⁷⁶

Morrison-Knudsen executed two separate contracts with the owner, one for design engineering services and one for construction. It performed a small portion of the design engineering services prior the execution of the construction contract, and the BTA did not impose sales tax upon the fee for those services, which amounted to \$891,500. The total fee for engineering design services performed on the project was approximately \$6.35 million. The BTA held that retail sales tax was due on all engineering services rendered after the execution of the construction contract, notwithstanding the existence of separate contracts for design engineering and construction. The BTA held that "in form there were two separate contracts," but "in substance WWP had one contract which places all design/construction responsibility for the Kettle Falls project within a single management team of M-K."⁷⁷ The BTA upheld the assessment of retail sales tax on the design engineering services performed after the contract to construct was signed. This case illustrates the potential liability that can arise when all design and construction responsibility resides within a single management team.

IV. SUMMARY AND RECOMMENDATIONS

When selling pure design services to the construction industry or the consumer, a design professional need not collect retail sales tax. Similarly, when providing an owner with contract administration services that do not directly relate to the physical act of constructing, those services are considered professional services, not retail sales, for taxing purposes. However, if the design professional's responsibilities are expanded to include the authority to direct and control how and when constructing activity takes place, its services can be deemed to be "in respect to constructing," such that the predominant activity under the contract is constructing, and the entire value of the design professional's contract can be subject to taxation as a retail sale. As explained above, a design professional's responsibility for constructing activities may be expressly contemplated and specified in its scope of work. Alternatively, authority for the

design professional to control construction activities may be an inherent feature of the project delivery method, as with IPD projects. In both cases, construction is the predominant activity, and the design professional must collect the retail sales tax from its client or be personally liable for paying the tax to the DOR.

Because tax questions are intensely fact-specific, contract administrators should consult an attorney about the potential sales tax implications associated with a particular contract during the contract negotiation phase. For standard contracts and teaming agreements, it may be possible to reduce the likelihood of triggering the retail sales tax by carefully identifying the design professional's duties under a teaming agreement in such a way that the designer is responsible for reviewing the work of others and communicating with members of the project team, but is not responsible for directing or supervising the construction. A statement that the design professional is not responsible for the contractor's means and methods is not sufficient. We recommend that designers also expressly state in the contract that the parties agree and intend that any guidance provided by the design professional regarding the performance of construction is solely for the purpose of ensuring the contractor's general overall compliance with the architect or engineer's design concept. It should be made abundantly clear that the design professional is not obligated to perform any construction activities either personally or through a third party, nor is it responsible for supervising or directing the construction work. This may afford the design professional the opportunity to avail itself of the safe harbor created in RCW 82.04.051(4): "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." Whether or not it is workable and realistic for a design professional to have such a narrowly defined, non-supervisory role on an IPD project is a question that must be answered on a case-by-case basis. To obtain a definitive answer regarding how state taxes apply in a particular set of circumstances, the owner, design professional, IPD team or company may request a binding letter ruling by writing to the Taxpayer Services Division, Taxpayer Information and Education Section of the Department of Revenue. When seeking a letter ruling,

it may be helpful to speak with a tax specialist or attorney regarding pertinent facts to include in the request.⁷⁸

We recommend that any teaming /overlay arrangement contain an explicit statement of intent, indicating that the purpose of the teaming agreement is to provide consulting and administrative services aimed at achieving optimal efficiency and integration in the performance of the separate agreements between the owner and each of the project participants. The statement of intent will serve to reinforce the limitations inherent in the scope of services and help to demonstrate that (1) the teaming agreement is not in and of itself a construction contract, and (2) even if it were somehow to be construed as a hybrid contract, its predominant purpose is to manage relationships among project participants, not to construct a structure. We caution that even with this protective language, there is still a risk that the DOR might regard the teaming agreement as being directly related to construction.

Finally, in circumstances where owners want a design professional to supervise and direct construction work, it is incumbent upon the architect or engineer to advise the owner of the sales tax implications of this request. We recommend that the design professional inform the client that taking on the full spectrum of construction management responsibilities will likely cause the entire scope of services to become taxable as a retail sale.⁷⁹

¹ Washington Senate Ways & Means Committee, “Final 2009-11 Operating Budget: Statewide Summary & Agency Detail” at 71, Apr. 25, 2009, published at <http://www.leg.wa.gov/Senate/Committees/WM/Documents/SenateBudget/2009/ConferenceCmte/FINAL09-11RecSum.pdf>.

² Washington Auditor of State, “Business Tax Amnesty Program Produces Big Results,” *The Audit Connection*, Summer 2011 at 1.

³ Washington Dep’t of Rev., “Temporary Amnesty Program Starts Today,” February 1, 2011, <http://dor.wa.gov/Content/AboutUs/newsroom/2011/021111.aspx>.

⁴ “The 2011-13 Operating Budget,” State Rep. Ross Hunter, Chairman of the House Ways & Means Committee, published at http://www.rosshunter.info/wp-content/uploads/2011/06/2011_Hunter_BudgetHandout-v2.pdf.

⁵ Govind S. Iyer, Philip M. J. Reckers and Debra L. Sanders “Increasing Tax Compliance in Washington State: a Field Experiment,” *National Tax Journal*, March 2010, 63 (1), 7–32.

⁶ RCW 82.04.290.

⁷ For example, the DOR treats as retail sales automobile towing, parking, credit bureau services and fees for amusement and recreation services including but not limited to golf, pool, billiards, skating, bowling, ski lifts and tows, and day trips for sightseeing purposes. See RCW 82.02.050.

⁸ Wash. Dep't of Rev., Det. No. 99-011R, 19 WTD 423 at 432 (2000).

⁹ Det. No. 01-140, 22 WTD 26 at 31 (2003); Det. No. 99-346, 19 WTD 891 at 899 (2000).

¹⁰ Det. No. 99-346, 19 WTD 891 at 900 (2000).

¹¹ Det. No. 98-194, 19 WTD 9 at 15 (2000); Det. No. 98-215, 19 WTD 26 at 32 (2000); Det. No. 99-152, 19 WTD 643 at 652 (2000).

¹² *Id.*

¹³ Det. No. 99-011R, 19 WTD 423 at 432 (2000).

¹⁴ *Id.*

¹⁵ Washington Final Bill Report, 1999 Reg. Sess. H.B. 2261 (June 25, 1999).

¹⁶ RCW 82.04.051(2).

¹⁷ <http://dor.wa.gov/content/doingbusiness/business/types/industry/construction/default.aspx>

¹⁸ Det. No. 99-346, 19 WTD 891 at 897 (2000).

¹⁹ *Riplinger v. Dep't of Rev.*, No. 51234 at 6 (Bd. of Tax Appeals 1998) (holding that “change order administration services do not appear to be significantly different in nature from accounting or legal services”).

²⁰ See, e.g., Det. No. 99-152, 19 WTD 643 at 653 (2000) (“The construction management activity [taxpayer] has performed for tenants and building owners do [sic] not constitute retail construction management activity.”).

²¹ See, e.g., Det. No. 99-001, 18 WTD 420 (1999); Det. No. 99-152, 19 WTD 643 (2000); Det. No. 99-346, 19 WTD 891 (2000).

²² Det. No. 99-152, 19 WTD 643 at 653 (2000).

²³ RCW 18.08.320(12).

²⁴ RCW 18.43.020(5)(a).

²⁵ Det. No. 99-001, 18 WTD 420 at 422 (1999); Det. No. 99-011R, 19 WTD 423 at 433; Det. No. 98-215, 19 WTD 26 at 29 (2000).

²⁶ Det. No. 99-001, 18 WTD 420 at 422 (1999); Det. No. 98-215, 19 WTD 26 at 29 (2000) (citing *Chicago Bridge and Iron v. Dep't of Rev.*, 98 Wn.2d 814, 659 P.2d 463, appeal dismissed, 464 U.S. 1013 (1983)).

²⁷ Det. No. 99-011R, 19 WTD 423 at 433.

²⁸ *Chicago Bridge & Iron Co. v. Dep't of Rev.*, 98 Wn. 2d 814, 818, 659 P.2d 463, 466 (1983).

²⁹ *Id.* at 822.

³⁰ *Id.* at 822-23.

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- ³¹ *Palmer v. Department of Revenue*, 82 Wn. App. 367, 372, 917 P.2d 1120 (1996).
- ³² Det. No. 99-011R, 19 WTD 423 at 433 (2000) (citing Webster's II New Riverside University Dictionary, 927 (1988)).
- ³³ *Id.*
- ³⁴ *State ex rel Carroll v. Gatter*, 43 Wn.2d at 160, 260 P.2d at 364.
- ³⁵ Det. No. 99-011R, 19 WTD 423 at 433 (quoting *State ex rel Carroll v. Gatter*, 43 Wn.2d at 153, 260 P.2d at 360).
- ³⁶ Det. No. 99-109, 19 WTD 398 at 405 (2000).
- ³⁷ Det. No. 90-123, 11 WTD 45 at 5 (1990).
- ³⁸ Det. No. 99-109, 19 WTD 398 at 405 (2000).
- ³⁹ *Id.* (emphasis added); see also RCW 08.08.320 (10).
- ⁴⁰ *Id.* at 405-406.
- ⁴¹ Det. No. 99-001, 18 WTD 420 at 421.
- ⁴² *Id.*
- ⁴³ *Id.* at 426.
- ⁴⁴ *Id.*
- ⁴⁵ Det. No. 90-123, 11 WTD 45 at 5 (1990).
- ⁴⁶ *Id.*
- ⁴⁷ *Id.*
- ⁴⁸ *Steele*, BTA Docket No. 47590 at 9 n. 3.
- ⁴⁹ *Id.*
- ⁵⁰ *Id.* at 9.
- ⁵¹ Det. No. 97-227, 17 WTD 99 (1998).
- ⁵² Det. No. 93-159, 13 WTD 316 (1994).
- ⁵³ *Id.* at 4.
- ⁵⁴ *Id.*
- ⁵⁵ Det. No. 98-215, 19 WTD 26 (2000).
- ⁵⁶ Det. No. 99-346, 19 WTD 891 (2000).
- ⁵⁷ *Id.* at 893.
- ⁵⁸ *Id.* at 894.

⁵⁹ *Id.* at 900-901.

⁶⁰ *Id.* at 901.

⁶¹ *Id.* at 901-902.

⁶² Det. No. 99-152, 19 WTD 643 (2000).

⁶³ *Id.* at 647.

⁶⁴ *Id.* at 652.

⁶⁵ *Id.* at 652-53.

⁶⁶ Det. No. 99-001, 18 WTD 420 at 425 (1999).

⁶⁷ *Id.* at 422.

⁶⁸ The AIA refers to the design professional as “Architect.” Where we quote from the AIA documents, we will use the word “architect,” but will otherwise use the word “designer” to refer to design professionals.

⁶⁹ Det. No. 99-001, 18 WTD 420 at 422.

⁷⁰ Under RCW 82.32.050(7), if the DOR finds that a taxpayer has attempted to evade tax, the Department is required to impose a nondiscretionary penalty of fifty percent of the additional tax due. *See also* Det. No. 99-001, 18 WTD 420 at 422.

⁷¹ Det. No. 87-93. 2 WTD 411 at 6 (1987).

⁷² *Id.*

⁷³ *See* RCW 82.08.050 and Det. No. 93-159, 13 WTD 316 at 5 (1994) (rejecting taxpayer’s request that DOR proceed directly against owner where contract between taxpayer and owner provided that if “a determination that sales tax is due and payable on the cost of the construction management services and fee,” the owner will pay the amount of the tax).

⁷⁴ RCW 82.03.180. *See also Booker Auction Co. v. Dep’t of Rev.*, 158 Wn. App. 84, 241 P.3d 439 (2010).

⁷⁵ *Washington Water Power Co. v. Dep’t of Rev.*, No. 85-169 (Bd. of Tax Appeals 1986).

⁷⁶ *Id.* at 3.

⁷⁷ *Id.* at 8.

⁷⁸ In the event of an adverse letter ruling, the taxpayer may seek further relief by petitioning to the appeals division of the DOR for a review of the letter ruling.

⁷⁹ *See* Det. No. 93-159, 13 WTD 316 at 5 (1994).