Cite as Det. No. 01-140R, 22 WTD 37 (2003)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Reconsideration of	)	D E T E R M I N A T I O N
	)	No. 01-140R[1]
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

RULE 170: RETAIL SALES TAX – CONSTRUCTION MANAGEMENT EARNED INCOME v. PARTNERSHIP DISTRIBUTION – INTERPRETATION OF A PARTNERSHIP AGREEMENT. Extrinsic evidence may be considered only to elucidate the meaning of the words of a contract, and not for the purpose of showing intention independent of the document. In re Marriage of Scweitzer, 132 Wash.2d 318, 937 P.2d 1062 (1997).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Taxpayer seeks a reconsideration of an earlier finding that held that Taxpayer owed retail sales tax on the monies it received from a partnership that were related to the development of a residential development.[2]

FACTS:

Lewis, ALJ -- Taxpayer is a general partner of a limited partnership, [LP], formed to develop and build a residential development on a . . . acre tract near . . . , Washington. The Department of Revenue's ("Department") Audit Division ("Audit") audited Taxpayer's books and records for the period May 13,1996 through September 30, 1999. On October 10, 2000, the Department issued a $ . . . tax assessment. Most of the tax resulted from the assessment of retail sales tax on

[1] Det. No. 01-140 is published at 22 WTD 26 (2003).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

amounts Taxpayer received from the partnership. Audit reasoned that retail sales tax was due because the payments were received for construction management and not as partnership distributions.

Taxpayer disagreed. On January 5, 2001, Taxpayer filed a petition requesting correction of the audit assessment. Taxpayer argued that the amounts it received from [LP] were nontaxable partnership distributions. Taxpayer maintained that as a partnership, it was entitled to receive payments from the partnership representing distributions of profits or return of contributed capital.

On September 26, 2002, the Department issued Determination No. 01-140. Det. No. 01-140 upheld the tax assessment, finding that the payments were not distributions of profit, but rather were payments for services provided. To determine Taxpayer's role as general partner, Audit requested a copy of the partnership agreement. After delays, Taxpayer supplied Audit with a "redlined" copy of the restated agreement.[3] Taxpayer maintained that the partners restated the Agreement to better reflect the Taxpayer's role.

The "redlined" Agreement showed what was deleted in the old agreement and restated in the new Agreement. The audit report listed some of the differences between the old and restated Agreement.

1. **Article 2.1 General Partner's Contributions (Pages 10-12)** – The restated agreement states that the General Partner's services and labor will be considered as contributions to the General Partner's Invested Capital account. The old agreement only stated that the General Partner may be entitled to receive credit for additional capital contributions relating to the "Supplemental Overhead allowance."

2. **Article 4.2 Powers of General Partner (Page 24)** – The restated agreement gives the General Partner powers to "supervise all planning, personnel, financial aspects and other Partnership business in connection with the Project, Lots and Units." The old agreement gives the General Partner powers to "supervise all planning, engineering, and development of the Project, to supervise development of the Lots and construction of the Units."

3. **Article 4.4.1 Management Duties (Pages 26-27)** – The restated agreement states that the General Partner shall not be a construction manager for the partnership. The old agreement states that the General Partner shall be responsible for management of activities, such as permit processing, development, and construction.[4]

[3] The "redlined" copy of the agreement contains both the text of the original Agreement and the changes.
[4] Section 4.4.1 of the old Agreement stated:

> The General Partner shall be responsible for overall executive management of the acquisition, planning, permit processing, development, construction, and sale of the Project, including but not limited to the following:

4. **Article 4.5 Compensation to General Partner (Pages 27-31)** – The restated agreement eliminates most of this article. The amounts designated as compensation in the old agreement are now stated in contributions in Article 2.1. The old agreement states that the General Partner will receive compensation for the services, materials, and facilities to be provided. The restated agreement discusses compensation for project personnel and other compensation only.[5]

5. **Article 9 Profits and Losses (Pages 49-51)** – Profits and loses are determined after amounts are paid to the General Partner. The restated agreement calls these amounts "LP Unmatched Capital Return" and the old agreement includes allowances and fees to be paid to the General Partner.

Article 10.2 Distribution Priority (page 52) – The restated agreement deletes the priority given in the old agreement to pay the General Partner overhead and administrative allowance.[6]

Audit's response to the restated Agreement was:

> The restated agreement purports to show that the General Partner is not receiving compensation for its services. However, the old agreement and the accounting records clearly do show that you were receiving gross income from construction management services. It is self-serving to change the agreement and make it retroactive to avoid the tax consequences of being a construction manager.

[5] Section 4.5.1 of the old Agreement stated:

> As its sole compensation for the services, materials and facilities to be provided pursuant to Section 4.4.2, the General Partner shall be paid by the Partnership a base overhead and administrative allowance up to an aggregate amount of $ . . . (the "Base Overhead Allowance"), and if and only if certain conditions are satisfied, the General Partner shall also be entitled to receive a supplemental overhead and administrative allowance, which is in addition to the Base Overhead Allowance, up to an aggregate amount of $ . . . (the "Supplemental Overhead Allowance"). Except as provided in Section 4.5.1.3 (provisions relating to a default by the General Partner), the Base Overhead Allowance shall be earned and paid as provided in Section 4.5.1.1. The conditions under which the Supplemental Overhead Allowance may be earned, and the timing and method of payment of the Supplemental Overhead allowance (except as provided in Section 4.5.1.3 if the General Partner is in default), are set forth in Section 4.5.1.2.

[6] Section 10.2 of the old Agreement stated:

> Cash assets available to the Partnership shall be applied first to pay any and all obligations then due and owing to third parties and/or to Partners (including but not limited to the LP Unmatched Capital Return, if any, General Partner overhead and administrative allowance, and Limited Partner loans to the Partnership and General Partner loans to the Partnership (concurrently), in that order of priority), and then to maintain Working Capital. Thereafter, any Cash Available for Distribution to the Partners shall be allocated and distributed as follows (except upon liquidation of the Partnership, when Cash Available for Distribution shall be allocated and distributed in accordance with section 11.6):

On October 25, 2001, Taxpayer filed a petition for reconsideration. Taxpayer argued that the determination was in error because the Department interpreted the joint venture agreements using a "plain meaning" standard. Taxpayer cited Berg v. Hudesman, 115 Wn.2d 657, 801 P.2d 222 (1990), to support its position that the correct standard was the "context rule" that allowed consideration of extrinsic evidence.

ISSUE:

Whether the interpretation of a partnership agreement should be made using a "plain meaning" standard or the "context rule," which allows for the consideration of extrinsic evidence in interpreting the document?

DISCUSSION:

Taxpayer cites Berg v. Hudesman, 115 Wn.2d 657, 801 P.2d 222 (1990), to support its position that the correct standard was the "context rule" that allowed consideration of extrinsic evidence. In Berg, the Court ruled, "[w]e now hold that extrinsic evidence is admissible as to the entire circumstance under which the contract was made, as an aid in ascertaining the parties' intent." Taxpayer argues that consistent with Berg, the Department must examine extrinsic evidence to determine the intent of the parties.

Subsequently decided cases have gone on to explain Berg. In re Marriage of Schweitzer, 132 Wn.2d 318, 937 P.2d 1062 (1997), the Supreme Court affirmed the Court of Appeals' refusal to consider extrinsic evidence, as to the parties intentions in signing a community property agreement, stating:

> The Court of Appeals was correct. In Berg v. Hudesman, 115 Wash.2d 657, 667, 801 P.2d 222 (1990), this court held extrinsic evidence is generally admissible to ascertain the intent of the parties to a contract. However, we made clear in Berg that this rule, known as the "context rule," authorizes the use of extrinsic evidence only to elucidate the meaning of the words of a contract, and "not for the purpose of showing intention independent of the instrument." Berg, 115 Wash.2d at 669 (quoting J.W. Seavey Hop Corp. v. Pollick, 20 Wash. 2d 337, 348-49, 147 P.2d 310 (1944)). We emphasized, "it is the duty of the court to declare the meaning of what is written, and not what is intended to be written." Berg, 115 Wash.2d at 669 (quoting Polluck, 20 Wash.2d at 348-49). We accordingly held in Berg that parol evidence cannot be used to "add to, modify, or contradict the terms of a written contract, in the absence of fraud, accident, or mistake," Berg, 115 Wash.2d at 669 (quoting Polluck, 20 Wash.2d at 348-49); see also U.S. life Credit Life Ins. Co. v. Williams, 129 Wash.2d 565, 570, 919 P.2d 594 (1996) ("'unilateral or subjective purposes and intentions about the meaning of what is written do not constitute evidence of the parties' intentions'.") (quoting Lynott v. National Union Fire Ins. Co., 123 Wash.2d 678, 684, 871 P.2d 146 (1994)). The Court of Appeals therefore correctly applied the Berg doctrine when it held extrinsic evidence of the parties' intent is generally not admissible to contradict the terms of a written agreement.

More recently, in Confederated Tribes of the Chehalis Reservation v. Johnson, 135 Wn.2d 734, 958 P.2d 260 (1998), the Court rejected the appellants argument that it was necessary to consider a general manager's declaration to determine the meaning of the terms contained in a tribal state gaming compact. The Court affirmed the ruling in Schweitzer, which explained the adoption of the "context rule" in Berg, stating:

> Berg's adoption of the "context rule" was recently explained by this court in In re Marriage of Schweitzer, 132 Wash.2d 318, 937 P.2d 1062 (1997), to permit consideration of extrinsic evidence only to elucidate the meaning of the words of a contract, and not for the purpose of showing intention of independent of the instrument.

The cases make clear a significant distinction. It is appropriate to introduce evidence to clarify the meaning of the words contained in a document. The introduction of outside evidence will not be admitted when the purpose is to introduce intent independent of the document.

In this case, Taxpayer has offered three pieces of evidence:

- The rewritten agreement. Taxpayer maintains the rewrite was made to better reflect the agreement between the parties.

- Refiled federal tax returns. Taxpayer maintains the refiling of the returns was to better reflect the agreement between the parties.[7]

- Written statements by the partners explaining that the agreement between the parties was for the general partner to receive partnership distributions and not compensation for services performed.[8]

The Supreme Court's more recent rulings are clear that they intend the "context rule" to be used as a tool to ascertain the parties' intent when interpreting written contracts. In Taxpayer's case, all the information offered as an aid to interpret the contract has been developed after the fact. As stated in Berg, quoting J.W. Seavey Hop Corp, "It is the duty of the court to declare the meaning of what is written, and not what was intended to be written." We believe the Court intended that the information provided be probative of the intent of the parties when the contract was executed. In this case, Taxpayer maintains it rewrote the contract to better reflect the actual activities and relationships of the parties. We find that Taxpayer's restatement of the contract does not offer evidence elucidating what was written, but what Taxpayer now wishes it had written.

[7] Taxpayer has offered to provide this document.
[8] Taxpayer has offered to provide this document.

Similarly, refiling the federal tax returns was done after the fact. It may be indicative of what Taxpayer's current intentions are, but does not show what Taxpayer's intentions were at the time of the agreement's drafting.

Finally, Taxpayer has offered to provide written statements from the partner's explaining what their intentions were when the partnership was formed. Essentially Taxpayer alleges that the affidavits, which are not even submitted, will say whatever is necessary for them to say to support the interpretation that the general partner was to receive a partnership distribution and not compensation for services. Such writings are subjective documents and are not probative of the meaning of a contract when it was written. Such documents may be discounted because they in fact vary its terms. In Hollis v. Garwood, 137 Wn.2d 683, 974 P.2d 836 (1999), the Court rejected evidence in the form of a subsequently drafted affidavit that attempted to add to or vary from the words of a contract, rather than explain them.[9]

The contract as written is clear. The general partner agreed to pay Taxpayer for providing certain construction management services. We find that the tax was correctly assessed because the monies it received from the general partner were for providing services and not as a partnership distribution of contributed capital or profit.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 22nd day of April 2002.

[9] In Hollis v. Garwood, 137 Wn.2d 683, 974 P.2d 836 (1999), Garwall argues that the trial court erred in refusing to consider extrinsic evidence, contained in the affidavit of Ron Matney, showing that the developers of the subdivision intended the restrictions to apply only to the smaller parcels of land included in the survey. The Court stated:

> However, this evidence is not admissible under Berg, as it is the unilateral and subjective intent of 1 of 10 of the original contracting parties. Garwall additionally contends that the Matney affidavit and the affidavit of the Stevens County plat administrator should be considered to show that the parties did not intend to limit the use of the land to residential purposes, but intended to "permit" residential use of the land. This interpretation contradicts the language of the plat which, itself, terms the limitation on use a "restriction." Additionally, the affidavit of Ron Matney shows that the intent of the subdividers was to restrict (not permit) at least the smaller parcels to residential use. The interpretation suggested by Garwall would require this court to redraft or add to the language of the covenant. Under Berg, the extrinsic evidence offered would not be admissible for this purpose. Extrinsic evidence is to be used to illuminate what was written, not what was intended to be written. Nationwide Mut. Ins. Co., 120 Wash.2d at 189.