

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D E T E R M I N</u>
<u>A T I O N</u>	)	
for Correction of Assessment of	)	No. 88-
362	)	
	)	
No. . . . .	)	Registration
	)	
No. . . . .	)	Tax Assessment
No. . . . .	)	Tax Warrant
	)	

[1] **MISC:** LIMITED PARTNERSHIP -- ASSESSMENT -- LIMITED PARTNER -- LIABILITY. The State of Washington, as a creditor, may enforce a limited partnership's obligation against a limited partner to the extent that that partner's obligation has not already been paid to the partnership.

[2] **RULE 228:** RCW 82.32.090 -- PENALTIES -- LATE PAYMENT -- INADVERTENCE. If a taxpayer fails to pay taxes by the due date, there shall be assessed a penalty, unless the delay was caused by circumstance beyond the taxpayer's control. Neither claimed ignorance of tax laws, nor excuse that contractor should have ensured taxes were paid, is such a circumstance.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: July 22, 1988

NATURE OF ACTION:

Petition regarding the imposition against both the general and limited partner of use tax and penalties on the value of a construction project on which no sales tax had been paid.

FACTS:

Burroughs, A.L.J. -- As a result of an audit covering the period from March 1, 1986 to December 31, 1987 the taxpayer was assessed \$ . . . in use tax and \$ . . . in interest, for a total due of \$ . . . . Tax warrant number . . . was issued on June 14, 1988 in the amount of \$ . . . , which amount included the five percent warrant penalty and interest.

The taxpayer, a Washington limited partnership, was the developer of a 108 unit apartment building project - designated " . . . " - in Lynnwood, Washington. The taxpayer, as owner-developer of the project, entered into an construction contract on September 23, 1986 with . . . (hereinafter "the prime contractor"), which was to serve as prime contractor on the project. The prime contractor was controlled by the same person which controlled the taxpayer's general partner.

Total cost of the project was to be \$ . . . . Payment of retail sales tax was not addressed in the contract.

On the very same day, the prime contractor entered into a subcontract agreement with the . . . ("the subcontractor") for the actual construction of the project. The original subcontract price was \$ . . . , subject to additions and deductions by change order. Again, payment of retail sales tax was not addressed in the contract. The prime contractor issued a resale certificate to the subcontractor on the same day the two contracts were signed - September 23, 1986.

Records available to the auditor - which included the construction contracts, purchase invoices, and check registers of the taxpayer, prime contractor, and subcontractor - indicate that \$ . . . was actually paid to the subcontractor in construction costs on the project - which amounts were paid by the taxpayer's general partner directly to the subcontractor. The subcontractor did not charge or collect retail sales taxes since it had been issued a resale certificate on the project.

The prime contractor, for the construction periods at issue, submitted tax returns reporting "no taxes due." Thus, neither retail sales taxes nor business and occupation taxes were reported or remitted by that entity for its participation in the project.

In the course of the audit, the taxpayer declined to supply the auditor with progress billings received from the prime contractor during the course of construction. Thus, the auditor was unable to determine whether any retail sales taxes had actually been paid by the taxpayer to the prime contractor. Records available to the auditor, in fact, reflected payments made directly by the taxpayer to the subcontractor, thereby bypassing the prime contractor entirely. The taxpayer has reported to the audit staff that the prime contractor has essentially no bank account or any other assets.

The audit staff concluded that the only function served by the prime contractor in the course of this project was its issuance of a resale certificate to the subcontractor to avoid payment of retail sales tax. Although the prime contractor will be assessed retail sales tax on the project, it is unlikely that collection is possible since that entity has no assets. Use tax has thus been assessed against the taxpayer-developer.

#### TAXPAYER'S EXCEPTIONS:

In its petition for correction of assessment dated June 20, 1988, the taxpayer objected to the assessment, claiming

1. That the limited partner should not have been assessed taxes, since he has neither a management position or control in the project's day-to-day operation.

2. That it paid the appropriate tax to prime contractor, . . .

Since submission of the petition, however, the taxpayer has reconsidered its position and admitted liability for the taxes assessed. The general partner has entered into a partial payment agreement for liability on the . . . project as a result of a separate assessment issued in its own name.

The taxpayer, however, does protest imposition of the five percent warrant penalty and the ten percent late payment penalty, contending that the individuals actually controlling the taxpayer - having come from California - did not fully understand the nature of Washington's tax obligations and should not thus be penalized. The taxpayer additionally stated that the contractor should have been responsible for making certain these taxes were paid.

#### DISCUSSION:

[1] As to the taxpayer's objection to the assessment against the limited partner, RCW 25.10.190 does provide for limited liability of a limited partner if he does not participate in the control of the business:

(1) Except as provided in subsection (4) of this section, a limited partner is not liable for the obligations of a limited partnership unless the limited partner is also a general partner or, in addition to the exercising of rights and powers as a limited partner, the limited partner participates in the control of the business. However, if the limited partner participates in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

Thus, the general rule is that a limited partner will not be personally liable for a limited partnership's obligations if he is not an active participant in the control of the business.

RCW 25.10.280(2), however, does provide for liability to creditors up to the amount of the limited partner's required contribution:

(2) Unless otherwise provided in the partnership agreement, the obligation of a partner to make a contribution or return money or other property paid or distributed in violation of this chapter may be compromised only by consent of the all the partners. Notwithstanding the compromise, a creditor of a limited partnership who extends credit, or whose claim arises, after the entering into of a partnership agreement or an amendment thereto which, in either case, reflects the obligation, and before the amendment or cancellation thereof to reflect the compromise, may enforce the original obligation to the extent that, in extending credit, the creditor reasonably relied on the obligation of a partner to make a contribution. [Emphasis added.]

The State of Washington, then, as a creditor which has reasonably relied on the obligation of the limited partner, may enforce a limited partnership's obligation against that limited partner to the extent that that partner's obligation has not already been paid to the partnership.

There has been no hard evidence presented as to the extent of the limited partner's participation in the control of the business or his contribution to the partnership. The Certificate and Agreement of Limited Partnership provides that

## 7. CAPITAL CONTRIBUTIONS.

### 7.1 Capital.

The capital contributions of the General Partner and the Limited Partner are set forth opposite the names of each Partner on Exhibit 1. Capital contributions shall be made at such time and in such manner as may be designated by the General Partner. No additional assessments may be made without the consent of the Limited Partner. Assessments against the Limited Partner will be paid to the extent possible in the form of offsets against the remaining balance owed by the partnership to the Limited Partner on the real estate purchase contract.

[Emphasis added.]

Exhibit 1 provides the nominal contribution by the limited partner to be \$25.00 in exchange for 25 units, and the general partner's nominal contribution to be \$75.00 in exchange for 75 units. It is

readily apparent that additional sizeable assessments on the limited partner were contemplated, the exact character and amount of which are presently unknown.

The Department has been supplied with little information regarding the limited partner's contribution other than testimony to the effect that the limited partner was not an active participant in the business and, further, that his contribution to the partnership had been paid in full. Such self-serving testimony, standing alone and without hard evidence, is insufficient.

The assessment and warrant against the limited partner will not be extinguished until sufficient evidence is supplied to the Compliance Officer at the Everett office to satisfy him that the limited partner's contribution has been paid in full.

[2] As to the ten percent late payment and warrant penalties, Washington's Revenue Act in RCW 82.32.090 provides as follows:

If payment of any tax due is not received by the department of revenue by the due date, there shall be assessed a penalty of five percent of the amount of the tax; and if the tax is not received within thirty days after the due date, there shall be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within sixty days after the due date, there shall be assessed a total penalty of twenty percent of the amount of the tax . . . .

If a warrant be issued by the department of revenue for the collection of taxes, increases, and penalties, there shall be added thereto a penalty of five percent of the amount of the tax . . . .

As an administrative agency, the Department does not have discretion to change the law. The only authority to cancel penalties or interest is found in RCW 82.32.105. That statute allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. The statute also requires the Department to prescribe rules for the waiver or cancellation of interest and penalties.

The administrative rule which implements the above law is found in WAC 458-20-228 (Rule 228, . . . ). Rule 228 lists the situations which are clearly stated as the only circumstances under which a cancellation of penalties and/or interest will be considered by the Department. None of the situations apply in the present case.

We further think it highly unlikely that the taxpayer's representatives were at any time unaware of how Washington tax liability applies in the construction of a development such as [the

project], since it appears that the entities and contractual relationships had been carefully, thoughtfully, and deliberately structured to avoid any such liability and leave the Department with entities with essentially no assets from whom to collect if ever discovered.

We particularly note that a resale certificate was promptly issued to the unrelated subcontractor, leaving that entity free from any responsibility for collection or ultimate payment; that the prime contractor - owned by out-of-state shareholders - was a mere shell with virtually no assets or bank accounts; and that the taxpayer has apparently divested itself of its interest in [the project] and any other sizeable assets.

It further appears that the general partner has entered into the partial payment agreement regarding taxes owed on the . . . project only because of the difficulty in receiving financing for other projects it just happened to have pending. Had the fifty percent evasion penalty been assessed, it would likely have been upheld.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment and warrant is denied.

DATED this 9th day of September 1988.