

Cite as Det. No. 13-0227, 35 WTD 366 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 13-0227
)	
. . .)	Registration No. . . .
)	

RULE 170; RCW 82.04.050, RCW 82.08.020, RCW 82.04.250: RETAIL SALES TAX – B&O TAX – JOINT VENTURE – SPECULATIVE BUILDER - PRIME CONTRACTOR – RESIDENTIAL CONSTRUCTION – OWNERSHIP OF LAND. The Department concluded that a construction company that built a residence on each of three parcels of land owned by another entity did not qualify for an exemption from tax as a speculative builder. The taxpayer argued that the construction was, in effect, the result of a joint venture and that the joint venture constructed the residences on land owned by the joint venture. However, the facts showed that neither the joint venture nor the taxpayer owned the land on which the construction occurred. Thus, the taxpayer was not exempt from tax on the construction of the three residences.

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.

Valentine, A.L.J. – [Taxpayer] is a Washington corporation in the construction business. Taxpayer protests an assessment of retail sales tax and retailing business and occupation (B&O) tax, asserting that the Department of Revenue (Department) erroneously classified Taxpayer as a prime contractor rather than as a speculative builder. Taxpayer's petition is denied.¹

ISSUE

Pursuant to WAC 458-20-170 (Rule 170) [and RCW 82.04.050(2)(b)], does Taxpayer qualify as a speculative builder when Taxpayer, in a joint venture with another company (a Washington limited liability company), constructed three single-family homes on land purchased and owned by the limited liability company (LLC)?

FINDINGS OF FACT

Taxpayer is a corporation owned by two shareholders (husband and wife) who also have a minority ownership interest in the LLC (48.5 percent, combined, in equal shares). In 2008,

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

Taxpayer entered into joint venture agreements with the LLC to build a single-family home on each of three land parcels owned by the LLC. The LLC purchased the three land parcels in 2006. The LLC solely borrowed the funds for the purchase and development of the raw land. When the three improved properties later sold, the LLC was listed on the escrow documents as the sole seller.

Taxpayer provided the Department with a copy of one of the joint venture agreements.² Pertinent sections read as follows:

This Joint Venture Agreement is made this 6th day of August, 2008 by and between [LLC] and [Taxpayer].

The purpose of this Agreement is to establish a joint venture to speculatively construct and sell a home on Lot 35 of . . . , a development owned by [LLC]. Toward this venture, [LLC] shall make available the land and obtain construction financing from [Taxpayer] shall contribute the plans and engineering for a 2725sf residence and shall then construct the residence.

It is agreed that the contribution of the land by [LLC] shall be \$. . . and the value of the residence to be constructed by [Taxpayer], including design, engineering, permits, course of construction insurance, all labor and material and standard warranty shall be initially valued as a contribution of \$. . . per the construction proposal which the joint venture partners agree is a good faith estimate of costs. The actual amount of [Taxpayer's] contribution to the joint venture shall be confirmed upon completion of the home construction including the effect of any change orders.

The cost of financing, holding costs, marketing and selling costs shall be expenses of the joint venture from the date hereof through the date of sale.

During the hearing, Taxpayer explained that “what it brought to the table was the contractor’s license.” Taxpayer further explained that it had the business structure, such as contractor’s license, subcontractors, and suppliers, in place to construct the three residences on the land parcels at issue. Taxpayer asserted that it was not feasible to set up the business structure under the joint venture. Taxpayer contended that it was acting as an agent for the joint venture during the construction process, using its resources on behalf of the joint venture.

Taxpayer provided the following reasons why title to the land remained solely with the LLC:

1. The bank loan to purchase the land had to be in the name of the land owner. Any entity or person who had an interest in the land would be included in the loan. If ownership interest in the land, at the time of purchase, included Taxpayer, Taxpayer, jointly with the LLC, would be liable for a multi-million dollar loan.

² Taxpayer explained that the three joint venture agreements are identical, with the exception of the specific building lot named in each agreement.

2. A quit claim transfer of the land from the LLC to Taxpayer, resulting in joint ownership, might have created real estate excise tax liability.
3. Taxpayer contends the joint venture agreements transferred ownership of the three land parcels at issue to the joint venture as a single entity; thus, no other transfer of ownership prior to construction was necessary for qualification as a speculative builder.

Audit contends that it properly treated Taxpayer as a prime contractor rather than a speculative builder for the following reasons:

1. The joint venture was not properly executed because the land remained in the name of the LLC.
2. The construction services were not performed in the name of the joint venture. The construction costs were billed to, and paid for by, Taxpayer.
3. These three building projects were custom construction because the construction services were performed by a member of the joint venture as a separate entity on land owned by the other member.

ANALYSIS

RCW 82.04.050(2)(b) defines “sale at retail” and “retail sale” as the “constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers.”³ RCW 82.08.020(1) imposes a retail sales tax on “each retail sale in this state.” RCW 82.04.250(1) imposes a B&O tax “[u]pon every person engaging within this state in the business of making sales at retail.”⁴

Rule 170(4) instructs that speculative builders pay retail sales tax on materials they purchase and on all work performed by their subcontractors. Rule 170(4) also instructs that prime contractors do not pay retail sales tax on such purchases, but must collect retail sales tax and pay retailing B&O tax on the “full contract price.”⁵

Rule 170(2)(a) defines a “speculative builder” as follows:

As used herein *the term “speculative builder” means one who constructs buildings for sale or rental upon real estate owned by him.* The attributes of ownership of real estate for purposes of this rule include but are not limited to the following: . . . The terms

³ RCW 82.04.190(4) defines “consumer” as “[a]ny person who is an owner, lessee or has the right of possession to or an easement in real property which is being constructed, repaired, decorated, improved, or otherwise altered by a person engaged in business.”

⁴ RCW 82.04.030 defines “person” as “any individual . . . joint venture . . . corporation . . . limited liability company . . . or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise.”

⁵ RCW 82.04.050(2)(b), RCW 82.04.250, RCW 82.08.020.

“sells” or “contracts to sell” include any agreement whereby an immediate right to possession of title to the property vests in the purchaser.

(Emphasis added.)

Rule 170(2)(f) expressly addresses the scenario where a corporation[, or the joint venture itself,] performs construction services on land owned by its co-venturers or shareholders as follows:

Persons, including corporations, partnerships, sole proprietorships, and joint ventures, among others, who perform construction upon land owned by their corporate officers, shareholders, partners, owners, co-venturers, etc., are constructing upon land owned by others and are taxable as sellers under this rule, not as “speculative builders.”

(Emphasis added.)

The Department has previously issued the following definition of joint venture:⁶

A joint venture is a “person” for Washington tax purposes. RCW 82.04.030. Each person doing business in Washington must register with the Department. RCW 82.32.030.⁷ Title 82 RCW does not “define” joint venture. Therefore, we look to its common and ordinary definition.

“Joint adventure” is defined as “any association of persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill, and knowledge” Black’s Law Dictionary 837 (6th ed. 1990). Similarly, a joint venture is defined as:

A legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit. [citation omitted]. An association of persons or companies jointly undertaking some commercial enterprise; generally all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern policy in connection therewith, and duty, which may be altered by agreement, to share in both profit and losses. (citation omitted). *Id.* At 839.

According to the Washington State Court of Appeals, . . . “[t]he distinction between a prime contractor and a speculative builder turns on whether the person performing the construction owns the real property on which the construction is performed.” *Dep’t of Revenue v. Nord Northwest Corporation*, 164 Wn. App. 215, 264 P.3d 259 (2011). The *Nord* case involved a dispute over the assessment of retail sales tax and retailing B&O tax on the construction and sales of two condominiums located on land owned by two limited liability companies. The construction of the condominiums was performed by an incorporated, licensed construction contractor (Nord) whose sole shareholder also had an ownership interest in the limited liability companies.

⁶ Det. No. 99-108, 19 WTD 143 (2000)

⁷ There is no evidence or claim in this case that the joint venture registered with the Department as a single entity.

The Appeals Court concluded that Rule 170(2)(a)'s second sentence "[does not] create an exception to the ownership requirement." Pertinent sections of the Appeals Court's *Nord* decision read as follows:

Neither the language nor the purpose of WAC 458-20-170(2) creates an exception to the requirement that the builder must be the bona fide owner of the real property to qualify as a speculative builder. . . .

In this case, Nord was a member of two LLCs and performed construction services on real property owned by those LLCs. [Nord] "perform[ed] construction on land owned by [its] co-venturers, etc." and was therefore "constructing upon land owned by others and [is] taxable as [a seller] under this rule, not as [a] 'speculative builder.'" . . .

And as discussed above, it is undisputed that the LLCs held title throughout construction, borrowed money from banks to pay for the construction, paid Nord for its construction services, and sold the condominium units to the eventual purchasers.

[164 Wn. App. at 228-30, 233 (quoting and applying WAC 458-20-170(2)(f)).] Also, the Department has previously concluded in the speculative builder context, that the corporate form should be respected unless there is a showing that the corporate form was used to violate or evade a duty.⁸ By filing its articles of incorporation, Taxpayer's corporate existence was conclusively proved.⁹ By its own admission, Taxpayer did not share title to the land with the LLC because it did not wish to be mutually liable for a multi-million dollar loan.¹⁰ Limited liability is the "corporation's most precious characteristic" and its existence is no reason to disregard the corporate form.¹¹

In addition, the Department has concluded in a previous decision that inter-related businesses operate as speculative builders only if the tax benefits afforded speculative builders are offset by the shared risk of legal liability:

Even assuming arguendo that the taxpayer, its owners, and their other LLCs had an "inter-related business," they were separately organized to enjoy the limited liability protections offered by their business structures. In short, the taxpayer and the LLCs seek the best of both worlds. They want the limited liability benefits afforded an LLC while enjoying the tax advantages afforded speculative builders when compared to prime contractors and their customers. Had the taxpayer, and its owners truly operated as a speculative builder they would have enjoyed the accompanying tax benefits, but with the risk of possibly greater exposure to legal liability for them jointly and severally. On the other hand, by acting as a prime contractor and not as a speculative builder, the taxpayer

⁸ Det. No. 89-252, 7 WTD 325 (1989) (citing *Molander v. Raugust-Mathwig, Inc.*, 44 Wn. App. 53, 59 (1986)).

⁹ RCW 23B.02.030.

¹⁰ [Taxpayer has the burden of showing that LLC transferred the property to the joint venture. In most cases, the transfer of ownership in real property to a joint venture can be established through transfer of title. However, absent a title transfer, the parties can still establish the transfer of ownership to the joint venture through other credible evidence.]

¹¹ *Equipto Div. Aurora Equip. Co. v. Yarmouth*, 134 Wn.2d 356, 375, 950 P.2d 451 (1998); *Truckweld Equip. Co. v. Olson*, 26 Wn. App. 638, 644, 618 P.2d 1017 (1980).

avoided the risk of possible legal liabilities faced by the owners of the properties (the LLCs). We cannot ignore or disregard the legal existence of the LLCs. *Washington Sav-Mor Oil Co., supra*. [Det. No. 08-0197, 28 WTD 76 (2009).]

Further, the Department has concluded that parties in a joint venture are jointly and severally liable for unpaid retail sales tax. [Det. No. 01-028, 20 WTD 514 (2001). In that case, the two couples who were] the parties to the joint venture “had jointly purchased real property on which a single-family residence was built[,] had jointly borrowed money to build the residence, and had divided the proceeds upon sale of the property.” In the present case, Taxpayer acknowledges that “a bank loan has to be in the name of the owner” and that “anyone that has an interest in the land would have to be a party to the loan.” Taxpayer expressly conveyed that it did not want to be “on the hook” for the multi-million dollar loan or for the development project. Thus, Taxpayer did not equally share in the risk. Taxpayer also acknowledged that title to the land was not extended to include Taxpayer because of potential real estate excise tax liability.

...

Thus, the Department concludes that Taxpayer provided construction services on land owned by its co-venturer All three land parcels in this case were owned by the LLC. At the time of land purchase, the listed purchaser of the properties was the LLC. The financing for the improvements to the land was secured and guaranteed by the LLC, and, after construction, the three improved parcels were sold by the LLC. [In conclusion, amounts received by Taxpayer for performing construction services on land owned by the LLC were properly characterized as payments to a prime contractor and subject to retail sales tax and retailing B&O tax.]

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 30th day of July, 2013.