Cite as 5 WTD 19 (1988)

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

In the Matter of the Petition For Correction of Assessment of)	D E T E R M I N A T I O N
)	No. 88-14
. . .)	Registration No. . . .

[1] **RULE 170:** JOINT VENTURE -- CONSTRUCTION CONTRACT -- FORMATION -- TAX CONSEQUENCES. A joint venture was found not to exist where no evidence of its creation was presented. A subsequent written joint venture agreement was not given retroactive effect. The transactions were thus treated as custom construction rather than speculative building. The guidelines set forth in 2 WTD 411 (1987) applied.

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: . . .

NATURE OF ACTION:

The taxpayer protests the assessment of Retailing business and occupation tax and retail sales tax on the construction of certain homes. The taxpayer contends that it was not a prime contractor in these transactions, but rather, a speculative builder.

FACTS AND ISSUES:

Mastrodonato, A.L.J. -- The taxpayer's records were examined for the period January 1, 1983 through December 31, 1986. The audit disclosed taxes and interest owing in the amount of $ [X]. Tax Assessment No. . . . in that amount was issued on October 13, 1987. The assessment has not been paid as the taxpayer believes that the assessment is not supportable and should be substantially modified.

The facts are generally not in dispute. The taxpayer is a construction company that is engaged in the construction of single

family residences, generally on a speculative basis. At issue is the retail sales tax and Retailing business and occupation (B&O) tax assessed on certain projects. The Department has classified these transactions as custom construction (i.e., retail sales) as set forth in the audit report and a letter to the taxpayer's attorney, dated September 11, 1987 (incorporated herein by this reference). In this latter document, the Department's auditor rejected the taxpayer's contention that these homes were built on a speculative basis.

The taxpayer disagrees and argues that these projects involve the construction of speculative homes. It points out that the projects designated as Jobs 42, 43, 44, 45, 46, and 78 (six of the questioned projects) were performed pursuant to a Joint Venture Agreement between three entities, the taxpayer, [A], and [B].

The taxpayer concedes that some of the land for these jobs was to be purchased jointly by the three partners (venturers), but was actually purchased by [B] individually. The taxpayer contends, however, that this purchase was the result of the inability of the taxpayer and [A] to obtain financing while [B] was able to obtain its own financing. The taxpayer argues that although [B] took formal title to the land, it was to be developed by the joint venture and work was performed on land equitably owned by the joint venture.

It is claimed that a different situation exists with respect to the projects designated as Jobs 88, 89, and 90. In these cases, a partnership agreement was entered into with respect to these projects. The taxpayer contends that the agreement reflects that the construction of the questioned homes was on land owned by the partnership.

However, the auditor noted that while the partnership agreement in question had an effective date of June 1, 1986, it was not signed until September 22, 1986, when most of the construction of the homes had already been completed. Thus, the Department has taken the position that an effective joint venture or partnership was not created. With this conclusion, the taxpayer respectfully disagrees. It argues that an effective partnership did, in fact, exist as of June 1, 1986.

The taxpayer also notes that some factual adjustments need to be made in the audit report and tax assessment. It contends that credits were not given for sales taxes paid on projects that were later determined to be speculative jobs. The taxpayer states that the overall impact of the failure to give these credits is significant.

Finally, the taxpayer makes the following additional arguments in support of its petition:

> Rule 170 sets forth the applicable rules relating to the constructing and repairing of new buildings on real property. The Rule deals extensively with the designation of builders as speculative builders as opposed to custom builders.
>
> The Rule expressly provides that partnerships or joint ventures performing construction on land owned by the individual venturers are not performing speculative building. If, on the other hand, the construction is performed on land owned by the joint venture, this is in fact speculative construction.
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> Each of the above-referenced jobs was performed on land either directly owned by or equitably owned by a joint venture. Thus, the homes were constructed on a speculative basis and purchases with respect thereto are not subject to retail sales tax.

In summary, the taxpayer submits that, for all of the foregoing reasons, the audit assessment should be corrected to designate the above-referenced jobs as speculative, rather than custom, construction, and also to reflect appropriate tax credits.

DISCUSSION:

[1] The taxpayer correctly points out that WAC 458-20-170 (Rule 170) is the administrative regulation dealing with the taxation of the construction of new buildings, including homes. As used in Rule 170, the term "prime contractor" includes a person who constructs new buildings for consumers. The term "speculative builder" means a person who constructs buildings for sale or rental (lease) upon real estate owned by the builder.

Prime contractors are taxable upon the gross contract price under the "retailing" B&O tax classification. Prime contractors also are required to collect from consumers the retail sales tax measured, again, by the full or gross contract price.

Speculative builders, on the other hand, must pay sales tax or use tax upon all materials purchased by them, and on all charges made by their subcontractors. There is no B&O tax due on the sale or lease of a "speculative" building.

We note that both the taxpayer and the auditor have characterized the arrangement between the parties as either a "partnership" or a "joint venture." For purposes of this decision, we assume that the parties intended to create a joint venture. With this assumption in mind, the Department relies on Black's Law Dictionary (Rev. 4th Ed. at 73), which defines a "joint venture" as:

> A commercial or maritime enterprise undertaken by several persons jointly; a limited partnership, -- not limited in the statutory sense as to the liability of the partners, but as to its scope and duration. . . . An association of two or more persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill, and knowledge. . . . A special combination of two or more persons, where, in some specific adventure, a profit is jointly sought, without any actual partnership or corporate designation. . . .
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> It is ordinarily, but not necessarily, limited to a single transaction, . . . which serves to distinguish it from a partnership, . . . But the business of conducting it to a successful termination may continue fora number of years. . . . There is no real distinction between a "joint adventure" and what is termed a "partnership for a single transaction." . . . A "joint adventure," while not identical with a partnership, is so similar in its nature and in the relations created thereby that the rights of the parties as between themselves are governed practically by the same rules that govern partnerships. . . . (Citations omitted.)

For Washington tax purposes, a joint venture is a separate "person." See RCW 82.04.030. Although each joint venture should be separately registered with the Department, often one member of a joint venture is already registered and reports the tax liability of the joint venture on its tax return(s). As a joint venture is in the nature of a partnership, the Department recognizes that the rights, duties, and liabilities of the parties are generally tested by the same rules. See, e.g., Barrington v. Murry, 35 Wn.2d 744 (1950). Furthermore, there is no requirement that the joint venture agreement be in writing, if the facts indicate the parties acted as a joint venture in performing the contract. 46 Am. Jur.2d Joint Venture, Sec. 1 (1969).

Rule 170 provides additional guidance when one attempts to determine whether a joint venture is acting as a prime contractor (custom construction) or a speculative builder. The rule states that:

> Persons, including . . . partnerships . . . and joint ventures . . . who perform construction upon land owned by their . . . partners, owners, co-venturers, etc., are constructing upon land owned by others and are taxable as sellers under this rule, not as "speculative builders."

WAC 458-20-170(2)(f). Having these general considerations in mind, the Department has set forth certain guidelines in determining the tax consequences applicable to joint ventures. These guidelines

can be applied to specific facts to determine whether a custom construction or speculative builder situation exists. The applicable inquiries are whether:

> (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. 2 WTD 411 (1987).

We find that, although there is evidence that requirements (1) and (5) were satisfied, the preponderance of the evidence discloses that these transactions failed with respect to requirements (2), (3), and (4).

In particular, requirement (2) states that the formation of the joint venture must occur before any of the work required by the contract has been undertaken. Here, the auditor reports, and the taxpayer concedes, that while the joint venture or partnership agreement had an effective date of June 1, 1986, it was not executed and signed until September 22, 1986. Furthermore, the auditor also reports that the majority of the construction work on the projects was actually performed prior to the execution of the agreement. Thus, requirement (2) has not been satisfied.

Moreover, guideline (3) requires that the construction work be actually performed by the joint venture. Here, the building permits all identified [the taxpayer] as the builder and it, in fact, performed all of the construction work.

Finally, guideline (4) requires that funds are to be handled by the joint venture rather than as the separate funds of any party to the joint venture. In this case, the auditor reports that purchases were made in [the taxpayer]'s name alone. Moreover, construction draws were also shown in [the taxpayer]'s records as revenue. Furthermore, with respect to Jobs 42, 43, 44, 45, 46, and 78, the taxpayer admits in its petition that the funds used to purchase the land were that of [B] alone. Therefore, the facts here are inconsistent with the requirements of guideline (4).

Consequently, notwithstanding the taxpayer's assertions to the contrary, it does not appear that these transactions qualify as speculative builder projects under the Department's rules and guidelines set forth above. We note that the Department's audit staff has agreed to review any additional documentation that will support the existence of a joint venture/speculative builder situation. With the additional guidelines set forth in this Determination, the Department continues to be available to review and/or adjust its audit report and tax assessment in accordance with the applicable laws and rules. However, in the absence of such additional information and documentation, we are constrained to uphold the audit report as written.

Finally, the taxpayer contends that it is entitled to credits for sales taxes paid which were not actually due. This is a factual matter which will be referred to the Audit Division for further review, verification, and/or adjustment.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment is denied with the following exceptions: The Audit Division will review the taxpayer's records regarding (1) the sales tax credits claimed and (2) any additional documentation establishing that a joint venture in fact existed and that it constructed the homes in question as a speculative builder, paying due consideration to the above discussion. If any adjustments are in order, the Department will issue an amended assessment, payment of which will be due on the date set forth therein.

DATED this 29th day of January 1988.