Cite as Det. No. 99-029, 21 WTD 184 (2002)

BEFORE THE 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. 99-029
. . .	)	Registration No. . . .
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PARTNERSHIP – ABILITY OF A GENERAL PARTNER TO BIND THE PARTNERSHIP. The action of a general partner who enters into an agreement within the scope of the partnership's business is the action of the partnership itself, binding the partnership, even if the general partner executes the agreement in his own name.

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:[1]

An appeal of assessments of business and occupation (B&O) tax on management fees that limited partners, acting as general partners, of investment partnerships maintained they did not receive.[2]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] Service Activities B&O tax was assessed on the management fee income prior to July 1, 1993. For periods after June 30, 1993 the financial business services B&O tax was assessed on the management fee income.

FACTS:

Lewis, A.L.J. – Taxpayers, . . . (collectively, [GP]) act as general partners in limited investment partnerships, . . . (collectively, [LP]). The investment partnerships are engaged in the business of investing the venture capital of their limited partners. Neither Taxpayers nor the investment partnerships have any employees.

When the investment partnerships were formed, two documents were simultaneously executed: a limited partnership agreement that required the general partners to manage the partnerships; and a management services agreement whereby the general partners contracted on behalf of the investment partnerships with a management company , . . . ([Management Co.]), to manage the investment partnerships.[3]

The limited partnership agreements provided that the general partners had "sole and exclusive control of management and conduct of the business including staffing, budgets, accounting, expenses and investment decisions", as well as, that "all investment decisions would be made by the general partner."

The management services agreements provide that the management services company will provide the investment partnerships with the needed management services. The investment partnerships made payment directly to [Management Co.]. The amount of [Management Co.]'s compensation was determined by Taxpayers' assignment of the management fees and reimbursement of expenses that they would have received from the investment partnerships had they provided the management services. Nothing has been presented to indicate that Taxpayers, the general partners, performed any management services themselves or were paid any of the management fees.

The Department of Revenue's Audit Division (Audit Division) audited Taxpayers' business records for the period January 1, 1990 through June 30, 1997. The Department issued audit assessments. The audit assessments were adjusted by means of subsequent post assessment adjustments. In July 1998 Taxpayers filed petitions requesting correction of the audit assessments, requesting cancellation of the B&O tax assessed on the fees paid by the investment partnerships directly to [Management Co.].

The Audit Division assessed Taxpayers B&O tax on the amounts the investment partnerships paid [Management Co.], even though Taxpayers neither performed the management services nor received payments from the investment partnerships. The Department reasoned that B&O tax was due because Taxpayers assigned the fees they would have received had they performed the management services without a reciprocal provision whereby [Management Co.] assumed the responsibilities of Taxpayers. The Audit Division viewed the Taxpayers' assignment of the management duties to

[3] [Management Co.] has seven officers and employees with extensive knowledge and experience in the management of venture capital funds. The limited partnership agreements and the management service agreements are the same for all the investment partnerships.

[Management Co.] as similar to a general contractor hiring a subcontractor to perform work. In such a circumstance, the general contractor remains liable for performance for the work, even though the actual work may be performed by the subcontractor. Accordingly, under Washington law, even if the payments are assigned to the subcontractor and never received by the prime contractor they would still be presumed to be *constructively* received by the general contractor and considered taxable income.

In July 1998 Taxpayers filed petitions requesting correction of the assessments. Taxpayers disagreed with the Audit Division's reasoning that signing the management services contract, as general partner, with [Management Co.] resulted in a contractor/subcontractor relationship. Taxpayers maintained that investment partnerships acted through them, the investment partnerships' general partners, to contract for the needed management services and that they performed no taxable activity and received no income.

ISSUE:

Whether the taxable activity and income of a third party service provider can be attributed to the general partner that contracted with the third party for services that benefited the partnership?

DISCUSSION:

The relationship of the parties was defined from the onset by two simultaneously executed documents: a limited partnership agreement and a management services contract. The partnership agreement and the management services agreement must be read together to determine what the parties intended. Estates of Wahl, 99 Wn.2d 828, 664 P.2d 1250 (1983) ("Documents executed together, however, are to be construed together.") Looking at the documents together, as required, it is clear that the management services company was required to provide services to the investment partnerships, and the investment partnerships were required to pay the management company for the services. It was also clear that the general partners were neither going to provide the management services nor get paid for them. The subsequent facts show that the parties performed in just that manner. The management services company performed the management services for the investment partnerships and the management services company got paid for its services by the investment partnerships. The taxable event was the management services company's performance of management services. Management services company paid B&O tax on the management fees it received. Nothing has been presented to show that Taxpayers, the general partners, either performed any management services or received any management fees. The management fees were directly wired from the investment partnerships to [Management Co.]. All the actions of the parties are consistent with the appointment of Taxpayers as general partners of the limited partnerships and Taxpayers signing a management agreement with [Management Co.] as general partner.

Under Washington partnership law, the action of a general partner who enters an agreement "within the scope of the partnership's business" (here, contracting for the management of the business) is the action of the partnership itself, binding the partnership itself, even if the general

partner executes the agreement in its own name. See Barnes v. McLendon, 128 Wn.2d 563, 573, 910 P.2d 469 (1996). That would have been true even if the management agreement had not mentioned the Taxpayers, . . ., anywhere in the agreement. That conclusion is even stronger here because: 1) the management agreement repeatedly referred to the investment partnership; 2) the management agreement expressly recited the general partner's role to act as the general partner of the venture capital limited partnership; and 3) the management agreement expressly obligated the investment partnership to pay the management fee directly to the management company (not to the general partner). Under Washington law, the management agreement is an obligation (contract) of the investment partnership itself with the management company. Thus, the burden of performing management services and the right to the management fee are the management company's and not Taxpayers, the general partners.

In addition, Washington partnership law provides that the partnership is charged with the knowledge of its partners (RCW 25.04.120) and that the act of a general partner "for apparently carrying on the business of the partnership…binds the partnership" (RCW 25.04.090(1)). See also RCW 25.10.240(1) (a general partner has the same powers in a limited partnership as in a general partnership). Thus, the general partner in executing the management agreement bound the investment partnership.[4]

In this case, the articles of formation of the Limited Partnership Agreements were signed by . . ., as Managing General Partner, not in his individual capacity. In addition, the management services agreements were signed by . . . of [Management Co.] and . . ., General Partner for [GP]. The manner of signing the agreements makes clear that . . . acted in his official capacity as General Partner of the investment partnership to contract on behalf of the investment partnership for management service to be provided by [Management Co.].

Finally, we are not persuaded by the Audit Division's reasoning that B&O tax was correctly assessed against Taxpayers because Taxpayers operated in a contractor/subcontractor relationship with the management services company. In the case of a contractor/subcontractor relationship the subcontractor performs work not for the consumer, but for the contractor. See, WAC 458-20-170(1)(b) (Rule 170). In this case, the documents make clear that the management services company performed its services, not for Taxpayers, but directly for the investment partnerships. In effect the management service company was a prime contractor to the investment partnerships and not a subcontractor to Taxpayer.

Based on the unique facts of this case, we find that Taxpayers acted in their capacity as General Partners of investment partnerships in contracting for management services. Thus, having found that Taxpayers neither performed taxable services nor were responsible to provide those services, we grant the relief requested. Taxpayers' files are remanded to the Audit Division for adjustments consistent with this decision.

[4] Note that this a is a consequence of Washington partnership law and the fact that the assignor in this case was the general partner of the partnership that is bound by the management agreement and its assignment provisions. Most parties would not be bound by another assignment without their consent, if the contract contained an effective prohibition against assignment without consent.

DECISION AND DISPOSITION:

Taxpayers' petitions are granted.

Dated this 19th day of February 1999.