

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. 97-189
)	
...)	Registration No. ...
)	FY. . . /Audit No. ...
)	
)	

[1] RULE 170; RCW 82.04.050: RETAIL SALES TAX -- RETAILING B&O TAX -- CUSTOM CONSTRUCTION -- SPECULATIVE CONSTRUCTION -- BENEFICIAL OWNERSHIP -- ATTRIBUTES OF OWNERSHIP. The mere holding of bare title to property is not determinative of ownership. Ownership is to be determined by the intent of the parties as evidenced by objective factors. Where title holder held title merely for security purposes, and all parties dealt with property as though taxpayers were the owners, taxpayers qualified as speculative builders.

NATURE OF ACTION:

Taxpayer protests the assessment of retailing business and occupation (B&O) tax and retail sales tax on the sale of six (6) condominiums maintaining that the units were custom construction and not speculatively built. In addition, Taxpayer protests the Department's assessment of retailing B&O and retail sales tax on the construction of a custom built home.¹

FACTS:

Lewis, A.L.J. -- In 1989, . . . (hereinafter "Mr. B") was the principal of . . . a Washington corporation. He was also the trustee of the (hereinafter "Trust").

. . . (hereinafter "Mr. G") was a vocational education teacher and was engaged in the part-time construction of residential homes. In 1988, . . . (hereinafter "P") approached Mr. G and asked if he was interested in acquiring property it owned, upon which he could speculatively build homes. Mr. G mentioned this possibility to his friend and neighbor, Mr. B. Mr. G indicated that

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

he wished to build speculative condominiums to be sold to the general public. Mr. B, the trustee of the Trust, indicated that he could help finance the purchase of the property, on the condition that the Trust receive a ten percent (10%) return on the loan. Subsequently, in 1989, Mr. B and Mr. G agreed to form a joint venture for the construction of the condominiums. This joint venture is hereafter referred to as "Taxpayers."

According to Mr. G, it was the intention of the parties that Taxpayers build speculative condominiums for sale to the general public, and that the Trust provide the financing to acquire the land. It was intended that the Trust be repaid the cost of the acquisition of the land, plus a ten percent (10%) return. No written agreement was entered into between the parties setting forth their understanding, but no party disputes that intention. The actions and conduct of the parties were consistent with the intent.

The deeded property contained six (6) lots upon which duplex condominiums could be built. Without the benefit of an attorney, or written documents, the parties entered into the transaction, wherein the Trust was deeded the real property and Taxpayers agreed to repay the Trust the cost of the lots plus ten percent (10%) interest. The Trust agreed to transfer the lots to the ultimate purchaser at the discretion of Taxpayers.

The parties agreed that whether or not the development was successful the Trust was entitled to receive the return of its principal plus ten percent (10%).

Taxpayers then obtained a line of credit from . . . [hereafter referred to as "Bank"] to fund the cost of construction of the condominium units. The Trust did not borrow money from Bank and had no responsibility to repay the moneys to Bank. The sole obligors under the transaction were Mr. and Mrs. G (husband and wife) and Mr. and Mrs. B (husband and wife).

The agreement between Mr. B and Mr. and Mrs. G was that any profits left after repaying the construction loan, and repaying the land loan, would be divided twenty-five percent (25%) to Mr. B. and seventy-five percent (75%) to the Mr. and Mrs. G. Mr. G had the principal responsibility to manage the construction of the units.

Although the terms of the loan were not in writing, the agreements and conduct of the parties were as follows:

1. The Trust made available to Taxpayers \$. . . to acquire six (6) duplex lots located in . . . , Washington.
2. The Trust was repaid as each lot was sold. One-sixth (1/6) of the purchase price plus ten percent (10%) interest.
3. The Trust retained title to the property as security for payment.

4. The Trust was entitled to the full principal and interest whether or not development was successful.
5. The Trust did not supervise, direct or participate in the construction of the condominium units. Only Taxpayers were responsible for the construction.
6. The Trust did not provide any additional funds and did not participate in any construction loans.
7. Taxpayers paid the real property taxes and all of the costs of developing the property. No funds were required from the Trust to develop the property.
8. All decisions relating to the location, design, method of construction, quality of construction of the condominiums, were made by Taxpayers. The Trust had no right to make any decisions relating to any of the construction on the property.
9. Taxpayers marketed the condominiums after they were constructed and signed all earnest moneys. The Trust did not participate in the marketing or sale of the condominium units.
10. The Trust's only interest in the transaction was to receive payment of the moneys used to purchase the land.
11. The Trust never requested rent nor did Taxpayers pay rent to the Trust for the use of the land.

The condominiums were built on a phase basis. The first four (4) condominiums were completed and sold on . . . , 1990. The first payment to the Trust was made on that date. One-sixth (1/6) of the principal amount plus ten percent (10%) interest. The total amount of principal and interest paid to the Trust was \$. . . upon the closing of Lot 1 and another \$. . . 11 on the closing of Lot 2.

On. . . , 1991, the condominiums located on Lot 3 were sold and the Trust was repaid \$. . . .

On . . . , 1991, the condominiums on Lot 4 were sold and the Trust was repaid \$. . . .

On . . . , 1992, the condominiums located on Lot 5 were sold and the Trust was repaid \$. . . .

On . . . , 1993, the condominiums on Lot 6 were sold and the Trust was repaid \$. . . .

The total principal and interest repaid to the Trust was \$. . . . The original investment by the Trust was [less than the amount of the repayment].

The earnest money agreements for the sale of the condominium units were signed by Taxpayers representative, Mr. G, and not by the Trust or its trustee. All marketing activity for the condominiums was done by Taxpayer.

The Trust did not receive any profits from the sale of the units, but merely received a return of the funds invested. At the time the last units were sold, there was a loss on the sale of approximately \$. . . . The Trust was repaid the cost of the land, plus interest at ten percent (10%) and Taxpayers made up the loss.

For excise tax purposes, Taxpayers considered the condominiums speculative construction and paid retail sales tax on the materials and subcontract labor.

The Department of Revenue (hereinafter "Department") audited the books and records of Taxpayer for the period January 1, 1990 to September 30, 1993. On August 2, 1995, the Department issued a \$. . . assessment. Most of the tax resulting from the Department's Audit Division (hereinafter "Audit Division") determination that the condominiums were custom construction and not speculatively built. As custom construction, the Department assessed retailing B&O tax and retail sales tax on the total amount of the condominium's construction costs. The Audit Division reasoned that the units were custom construction because they were built on land that Taxpayers did not own.

On September 5, 1995, Taxpayers filed a petition requesting correction of the assessment. Taxpayers disagreed with the Department's determination that the condominiums were not speculatively built. Taxpayers maintained that they were the owners of the land on which the condominiums were built. They maintained that although they did not have legal title to the land they did have beneficial ownership.

In addition, Taxpayers disagreed with the amount of retailing B&O and retail sales tax assessed on a custom home built for [Mr. and Mrs. A]. The Department assessed tax on a \$. . . value. Taxpayers maintained that the value of the construction was only \$. . . .

ISSUE:

Will a taxpayer/contractor be deemed a speculative builder when it builds a structure on land that it does not have legal title?

DISCUSSION:

The Audit Division treated the condominium project as custom construction, rather than speculative construction, on the basis that the land was owned by the Trust at the time the construction occurred. Taxpayers maintained that they were a speculative builder because at the

time they had beneficial ownership of the property and the Trust only held legal title for security purposes.

RCW 82.04.050(2)(b) defines “retail sales” as follows:

The constructing, repairing, decorating, or improving of new or existing buildings, or other structures under, upon, or above real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include the sale of services or charges made for the clearing of land and the moving excepting the mere leveling of land used in commercial farming agriculture.

The central issue, therefore, is whether or not the construction was done “upon or above real property of and for consumers” and specifically, whether the Trust, at the time the construction occurred, was the “consumer.”

RCW 82.04.190(4) defines “consumer” as follows:

Any 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, excluding only....

WAC 458-20-170(2)(a) defines “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: (i) The intentions of the parties in the transaction under which the land was acquired; (ii) the person who paid for the land; (iii) the person who paid for improvements to the land; (iv) the manner in which all parties, including financiers, dealt with the land. The terms "sells" or "contracts to sell" include any agreement whereby an immediate right to possession or title to the property vests in the purchaser.

Thus, according to Rule 170 the mere holding of bare title to the property is not determinative of ownership. Rather, the issue of ownership is to be determined by, the intent of the parties as evidenced by the objective factors, i.e., the person who paid for the land, the person who paid for the improvements, and the manner in which all parties dealt with the land.

In this case, during construction, Taxpayers had the right to possession of the property and, in fact, operated as the possessor of the property. They occupied the land; constructed the condominiums; borrowed money for construction of the buildings; paid the real property taxes on the buildings;

marketed the condominiums; and eventually, signed all earnest money agreements for the sale of the condominiums. According to Taxpayers, the Trust did nothing with respect to possession of the real property or the condominiums built on the real property, except receive repayment of the original cost of the undeveloped land, plus ten percent (10%).

Pursuant to the intentions of the parties Taxpayers exercised all the rights of the possessor of the real property, subject to the security interest held by the Trust. While the Trust paid for the land, Taxpayers paid for all the construction on the land. All parties dealt with the land as though Taxpayers were the owners of the land. The Trust participated in this transaction in only three respects:

1. It contributed money for the benefit of Taxpayers to acquire the undeveloped land.
2. It held title to the property.
3. It conveyed title to the ultimate purchaser at the direction of Taxpayers.

The Trust did not participate in the construction and did not direct any of the construction. The condominiums were not built for the Trust's benefit.

During the course of the construction, no funds of the Trust were used and no payments were made to Taxpayers for construction. At the time of closing, no funds were paid from the Trust to Taxpayers.

Taxpayers contended that the Trust held the property in a resulting trust². Washington has adopted the test of the Restatement (Second) of Trusts for determining whether a resulting trust has arisen. Manning v. Mount St. Michael's, 78 Wn.2d 542, 477 P.2d 635 (1970). A resulting trust arises where the party transferring the property does not intend the beneficial interest to vest in the transferee. In RE Washborn and Roberts, Inc., 795 F.2d 870 (1986).

Taxpayers not only contended that the Trust held the property as a resulting trust, but also as security for the moneys lent. Taxpayers maintained that the deed held by the Trust was actually a mortgage interest held as security for the repayment of the loan plus ten percent (10%) interest.

A deed may be found to operate as a mortgage when evidence is presented that both parties so intended. Parker v. Speedy Re-Finance, 23 Wn. App. 64, 596 P.2d 1061 (1979). Thus, it is the intention of the parties that control, not the form of the deed.

² A resulting trust arises "where a person makes or causes to be made a disposition of property under circumstances which raise an inference that he does not intend the person taking or holding the property should have the beneficial interest therein." Restatement (Second) of Trusts 404 (1959). The trust exists because the person who holds the property is not entitled to the beneficial interest.

In Berg v. Hudesman, 115 Wn.2d 657, 801 P.2d 222 (1990) the Court gave direction in determining the intentions of the party, stating:

In discerning the intentions of the parties' intent, subsequent conduct of the contracting parties may be of aid, and the reasonableness of the parties' respective interpretations may also be a factor in interpreting a written contract.

The rule with respect to a deed absolute on its face being treated as a mortgage, is comparable and similar to the requirements of Rule 170. The intentions of the parties govern and are determinative. In this case, there appears to be no dispute regarding the parties intentions. All parties state that their intentions were to treat the deed as security to ensure the payment of the cost of acquisition of the land. The actual intentions of the parties were confirmed by the actions of the parties, in which all parties treated the obligation owed to the Trust as a debt, which was paid from the proceeds of the sale. Accordingly, we find that pursuant to Rule 170 Taxpayers were the owner, possessor and consumer of the real property upon which the condominiums were built. Thus, we grant Taxpayers' petition finding that the condominiums were speculatively built.

Taxpayers also raised a factual issue. They maintained that the Audit Division erred in assessing retailing B&O and retail sales tax on a custom home built for [Mr. and Mrs. A]. . . . The Audit Division assessed the tax on a \$. . . value - allowing a retail sales credit for \$. . . paid on materials and subcontracting labor. Taxpayers alleged that the construction loan given to the buyer was for [less than the amount on which the assessment was based] and that it represents the value of the construction subject to retailing B&O and retail sales tax. Thus, Taxpayers maintained that they only owed retail sales tax on the \$. . . - the difference between the \$. . . paid for materials and subcontracting labor and the \$. . . amount of the construction loan.

Rule 170 provides that retailing B&O tax and retail sales tax is due on the gross contract price. In the absence of a gross contract price the measure of the retailing B&O tax and retail sales tax is "the total amount of construction costs, including any charges for licenses, fees, permits, etc., required for the consideration and paid by the builder." Rule 170 is clear. We agree with Taxpayer that if \$. . . was the total amount of the construction costs then that is the amount subject to tax. However, Taxpayers must document this assertion. Accordingly, this issue is remanded to the Audit Division for review of Taxpayers' documentation of the \$. . . total construction costs.

DECISION AND DISPOSITION

Taxpayers' petition is granted as it relates to its claim that six duplexes were speculatively built. Taxpayers' claim that the measure of tax regarding the [Mr. and Mrs. A's] residence is \$. . . is remanded to the Audit Division for verification.

Dated this 26th day of September 1997.