Cite as Det. No. 99-176, 19 WTD 456 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 99-176
. . .	)	Registration No. . . . FY. . . / Audit No. . . .
. . .	)	Registration No. . . . FY. . . /Audit No.. . .

[1] RULE 170: RETAIL SALES TAX -- RETAILING B&O TAX – JOINT VENTURE – SPECULATIVE BUILDING. Taxpayers and their co-venturers formed joint ventures because they acquired and contributed land, money, skill, knowledge, and experience to their home-building enterprises while sharing profits and losses without receiving absolute payments for services they respectively rendered. Consequently, retail sales tax and retailing B&O tax were not due on the full contract prices of houses the taxpayers and their co-venturers sold because they were speculative builders.

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:

An individual contractor and his wholly-owned corporation (the taxpayers) protest the assessments of retail sales tax and retailing business and occupation (B&O) tax on the construction and sale of several single family residences.[1]

FACTS:

De Luca, A.L.J. (Successor to Bauer, A.L.J.) – The taxpayers are in the business of constructing single-family residences in Washington. The taxpayers entered into oral agreements with other individuals (co-venturers) to build numerous houses on a speculative basis for subsequent sale to the general public. The taxpayers, as contractors, had the expertise and knowledge to build homes. The co-venturers provided the land and the capital to finance the construction costs.

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

The Audit Division of the Department of Revenue (the Department) reviewed the individual contractor's books and records for the period October 31, 1993 through December 31, 1994 and assessed $. . . in retailing B&O and retail sales taxes and interest. The Audit Division credited the individual contractor for sales taxes he paid at source. Document No. . . . /Audit No. . . . . The Audit Division also reviewed the books and records of the contractor's corporation for the period January 1, 1995 through December 31, 1995 and assessed $. . . in retailing B&O and retail sales taxes and interest, while crediting the corporation for sales taxes it had paid at source. Document No. . . . /Audit No. . . .

The Audit Division recognized that the taxpayers "thought [they] were speculative building…." The Audit Division conceded "[the taxpayers'] intention was definitely to engage in speculative construction." Indeed, the Audit Division does not dispute that the taxpayers shared profits and losses on a 50/50 basis with their co-venturers. There were no absolute or guaranteed payments to the taxpayers. If no profit was realized in the venture, the taxpayers received nothing for their services. The Audit Division confirmed the taxpayers "did a very good job of paying tax at source on the purchase of materials and the subcontract labor."

Nonetheless, the Audit Division declared the taxpayers actually were prime contractors engaged in custom construction and assessed retail sales tax and retailing B&O tax on the full selling prices of the houses. The Audit Division based its decision on a five-part test announced in Det. No. 87-93, 2 WTD 411 (1987) to determine whether a joint venture exists and, therefore, engaged in speculative building, or whether custom construction occurred. The Audit Division denied that a joint venture between the taxpayers and the co-venturers existed for two reasons. One, title to the lands was not in the taxpayers' names, but in the names of their co-venturers. Thus, the Audit Division believed the work was not actually performed by the joint venture. Two, the accounting of the projects did not appear to the Audit Division to be done as joint ventures. Specifically, the Audit Division found the third-party vendors billed the taxpayers. The taxpayers presented the bills to their co-venturers who would cut checks to the taxpayers. The taxpayers would then pay the vendors for their materials and subcontract labor.

TAXPAYERS' EXCEPTIONS:

The taxpayers argue they formed joint ventures with the co-venturers, who contributed the land and capital, while the taxpayers provided construction knowledge, experience, and skill to build the houses. Consequently, the taxpayers claim they were speculative builders pursuant to both common dictionary definitions and WAC 458-20-170(2)(a)(i) (Rule 170). That is, the taxpayers and their co-venturers "speculated" by taking part in a risky business venture on the chance of making a profit. Further, they acquired the land with the intention to build and sell the houses as speculative builders. As noted, profits and losses were split on a 50/50 basis between the taxpayers and the co-venturers on each house sold. The taxpayers add that, in fact, many of the houses were sold at a loss.

ISSUE:

Did the taxpayers form joint ventures with the co-venturers, who contributed land and capital, to construct houses as speculative builders and sell them to the general public?

DISCUSSION:

Rule 170 is the administrative rule dealing with the taxation of the construction of buildings. As used in Rule 170, the term "prime contractor" includes a person who constructs new buildings for consumers. The term "subcontractor" means a person who engages in work similar to that performed by a contractor, but who performs the work for persons other than consumers. Prime contractors are taxable under the retailing B&O tax classification, and subcontractors under the wholesaling B&O tax classification, upon the gross contract price. Prime contractors also are required to collect from consumers the retail sales tax measured by the full contract price.

By contrast, proceeds of sales by speculative builders of completed buildings are not subject to B&O tax because sales of real estate are exempt from B&O tax.[2] Likewise, the retail sales tax does not apply to speculatively built houses because no charge is made for construction for a consumer. Instead, the price is paid for the tax-exempt sale of real estate. However, speculative builders must pay sales tax upon all materials purchased by them and on all charges made by their subcontractors. Rule 170(2)(c) and (e).

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. 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. Det. No. 87-93, *supra.* In the present matter, the taxpayers are each registered in their own names with the Department to do business in Washington and have been filing excise tax returns and paying taxes.

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 the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses. [Citation omitted].

Id. at 839. 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. Det. No. 87-93, *supra*.

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[2] Sales of Real estate are subject to real estate excise tax (REET) under Chapter 82.45 RCW.

A joint venture is in the nature of a partnership. *Barrington v. Murry*, 35 Wn.2d 744, 752, 215 P.2d 433 (1950). However, the venturers can perform different functions, as the Supreme Court in *Barrington* stated:

> It is, of course, unnecessary that every member of a partnership must be able and qualified to do every act required to further its general purpose. For example, one can undoubtedly be a partner in the business of manufacturing watches without being himself able to make a watch or the simplest part thereof.

Id. See also Refrigeration Engineering Co. v. McKay, 4 Wn. App. 963, 973-74, 486 P.2d 304 (1971).

In light of some of these definitions and authority, the Department announced a five-part test in Det. No. 87-93, *supra*, that it, at times, has used to determine the existence of a joint venture. Those parts include: (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, <u>and</u> (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.

The Audit Division agrees the taxpayers and their co-venturers joined together to build the houses and sell them to the general public. The Audit Division concurs their agreements were in place prior to starting construction. The Audit Division also agrees that there was a sharing of profits upon completion of the projects. Thus, the Audit Division acknowledges that the taxpayers meet at least three of the five elements announced in Det. No. 87-93.

As noted, the Audit Division contends that the taxpayers failed to meet the third and fourth elements of the test. That is, the Audit Division believes the contract work was not performed by a joint venture because the taxpayers did not have record title to the land in their names. Record title was in the name only of the co-venturers. However, the mere holding of record title to real property is not determinative of ownership. *See* Det. No. 97-189, 17 WTD 148 (1998) and Det. No. 94-154, 15 WTD 46 (1994).[3] The Audit Division additionally believes joint ventures did not perform the contracts because the co-venturers only provided the land and financing while the taxpayers did the rest of the work on the projects. But, as we have shown, venturers can perform

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[3] Rather, the issue of ownership is determined by factors that include, but are not limited to, the intent of the parties in acquiring the land, 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. Rule 170(2)(a). The lots were acquired with the intention of having the joint ventures develop the property. The taxpayers admittedly did not pay for the land and did not put up the money for the improvements. Their co-venturers did. However, the parties dealt with the land as joint venture property, as witnessed, in part, by pooling their resources to begin and complete the projects, and sharing profits and losses from sales of the properties. Thus, there are key factors that indicate the properties were owned and developed by the respective joint ventures.

different functions. *See Barrington*, *supra*, where, as quoted above, the Washington Supreme Court stated "one can undoubtedly be a partner in the business of manufacturing watches without being himself able to make a watch or the simplest part thereof." 35 Wn.2d at 752.

The Audit Division further believes the accounting used by the taxpayers was not done as a joint venture. Specifically, the third-party vendors billed the taxpayers, who, in turn, provided the bills to the co-venturers. The co-venturers then cut checks to the taxpayers for like amounts. The taxpayers then paid the vendors from those funds. Granted, this method of paying the invoices appears to involve more steps than if the taxpayers and the co-venturers had established joint checking accounts to pay the bills. Nonetheless, the taxpayers and their co-venturers acted in a way that was not inconsistent with a joint venture. *See* Det. No. 87-93, *supra*. In that case, normally only the contractor's name was stated as the purchaser on the third-party vendors' invoices, but his co-venturer kept the records and paid the invoices directly. Indeed, in the present matter the co-venturers took the additional step of entrusting the taxpayers with the money to pay the vendors. Thus, in the present matter there was a common handling and payment of funds by the taxpayers and their co-venturers. In both cases, the contractors and their co-venturers trusted and relied on each other to perform their respective tasks such as purchasing materials and labor, sharing information about their costs, and paying the invoices. Additionally, in the present matter, profits and losses from the sales were treated as belonging to the joint venture prior to distribution. After reviewing these facts, plus the facts related to the other four elements described above, we find the taxpayers have met the test described in Det. No. 87-93, *supra*, to determine the existence of a joint venture.

The Washington Supreme Court also has proclaimed a common law test in determining the existence of a joint venture. The Court stated the essential elements of a joint venture are (1) a contract, express or implied; (2) a common purpose; (3) a community of interest; and (4) an equal right to a voice, accompanied by an equal right to control. *Carboneau v. Peterson*, 1 Wn.2d 347, 374, 95 P.2d 1043 (1939) and *Paulson v. County of Pierce*, 99 Wn.2d 645, 654, 664 P.2d 1202 (1983). The Supreme Court in *Carboneau* explained those elements. First, a contract binds the parties who enter into it and, when made, obligates them to perform it, and failure of any of them to perform constitutes, in law, a breach of contract. Second, the purpose of the enterprise, whether it is for business, pleasure, or for some other objective, must be common to both, or all, parties, and not separate. Third, there must be a community in the performance of the purpose. This element is connected to the common purpose element, but is still a distinct factor. A community interest in a joint venture means an interest common to both parties, that is, a mixture or identity of interest in a venture in which each and all are reciprocally concerned and from which each and all derive a material benefit and sustain a mutual responsibility. Fourth, each of the parties must have an equal right in the management and conduct of the undertaking, and that each may equally govern upon the subject of how, when, and where the agreement shall be performed. 1 Wn.2d at 374-376. The courts have generally included the additional requirement of sharing profits and losses. However, parties can agree not to share losses:

> Additionally, there must be a sharing of profits and losses in order for there to be a joint venture. Knisely v. Burke Contract Accessories, Inc., 2 Wn. App. 533, 468 P.2d 717 (1970).

> However, the parties need not expressly agree to share the losses. Eagle Star Ins. Co. v. Bean, 134 F.2d 755 (9th Cir. 1943); *See* 46 Am. Jur.2d Joint Ventures, §13 (1969).

Refrigeration Engineering, supra, 4 Wn. App. at 974. *See also* Det. No. 88-155, 5 WTD 179, 191 (1988) (applying *Carboneau*).[4]

We agree with the taxpayers that their joint ventures meet all of the common law elements of a joint venture described in *Carboneau* and *Refrigeration Engineering*. First, the Audit Division concedes the taxpayers and their co-venturers formed contracts with the intent to speculatively build the houses. Second, all the parties to the joint venture agreements had the common purpose to speculatively build the houses and sell them to the general public. Third, there was a community of purpose in which the taxpayers and their co-venturers shared mutual responsibilities and all would derive material benefits, such as profits. Fourth, there was an equal right in managing the ventures, for example, such as in making decisions about the number and types of houses to build and where to build them. Lastly, it is undisputed that all of the parties to the joint ventures shared profits and losses.

Additionally, we note the distributions to the taxpayers were not absolute payments that were payable to them in any event, regardless of whether or not the profits of the joint ventures were adequate to meet the payments. This situation is similar to the one described in Excise Tax Advisory 073.08.106 (ETA 73). The present situation also favorably compares with the one in Det. No. 90-74, 3 WTD 431 (1990). There, the Department held that payments by a partnership to a partner were nontaxable distributions of profit because they were not absolute payments to a partner for services rendered like those of a third party service provider.

We have reviewed the facts in light of the common law test for a joint venture announced in *Carboneau*, and the five part test discussed in Det. No. 87-93, plus the fact there were no absolute payments to the taxpayers, but only a sharing of profits and losses. We find the taxpayers did form joint ventures when they and their co-venturers decided to acquire and contribute their respective properties, money, skill, knowledge, and experience to speculatively build the houses and sell them to the general public. We find the taxpayers were speculative builders along with their co-venturers.

DECISION AND DISPOSITION:

The taxpayers' petitions for correction of assessments are granted.

Dated this 14th day of June 1999.

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[4] The four requirements in *Carboneau*, plus a sharing of profits and losses, are compared to the five elements test announced by the Department in Det. No. 87-93, *supra*, in determining the existence of a joint venture. Whether the Department uses the *Carboneau* test, plus a sharing of profits and losses, or the five elements test may be in the ease of applying which test to particular facts and circumstances.

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