

Cite as Det. No. 05-0104, 26 WTD 1 (2007)

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. 05-0104
)	
...)	
)	Registration No. . . .
)	Doc. No. . . . Audit No. . . .
)	Docket No. . . .
)	

RULE 170, RULE 203; RCW 82.04.050, RCW 82.04.030: RETAILING B&O TAX -- RETAIL SALES TAX -- JOINT VENTURER VS. PRIME CONTRACTOR. Where the preponderance of evidence showed that the parties did not intend to form a joint venture, the parties did not have equal control over the construction project, and the parties did not share project profits and losses, a joint venture was not created.

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.

Okimoto, A.L.J. – A construction company protests the assessment of additional retail sales taxes on amounts received from a landowner for construction services contending that they had previously created a joint venture and were engaged in speculative construction together. We deny Taxpayer's appeal.¹

ISSUE:

Did the terms of an Independent Contract Agreement between a construction company and landowner create a joint venture?

FINDINGS OF FACT

[Taxpayer] is a sole proprietorship engaged in the business of constructing single family residences and apartment complexes [in] Washington. Taxpayer is also a licensed contractor. The Audit Division (Audit) of the Department of Revenue (DOR) examined Taxpayer's books and records for the period January 1, 1999 through December 31, 2002. The examination

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

resulted in additional taxes and interest being assessed Taxpayer appealed and the amount remains due.

Taxpayer originally registered to do business in Washington in 1995. During the first few years, Taxpayer mainly performed construction consulting services and some speculative building Sometime early in the year 2000 Taxpayer met [Landowner], who had recently purchased a city block in . . . Washington. Although the lots were platted, Landowner was unable to sell them because of poor market conditions. Landowner initially hired Taxpayer as a consultant to perform a feasibility study on whether Landowner could profitably hire a contractor and construct and sell completed homes on a speculative basis. The study concluded that this scenario would not be profitable, so Landowner began considering other alternatives.

The alternative that Landowner settled on would be to finance the construction of the houses, himself, and have Taxpayer perform the construction services for a specified portion of the gross proceeds from the sale of the houses.

Consequently . . . Taxpayer and Landowner entered into a construction contract Under the terms of the [Agreement] between Taxpayer and Landowner, Taxpayer was required to build three homes in . . . Washington. The contract provided:

DESCRIPTION OF SERVICES. . . . , [Taxpayer] will provide the following services, (collectively the “Services”): To act as general contractor in building and selling three single-family residences on property presently owned free and clear by [Landowner]. . . .

- 1) PERFORMANCE OF SERVICES. [Taxpayer] shall determine the manner in which the services are to be performed and the specific hours to be worked by [Taxpayer]. [Landowner] will rely on [Taxpayer] to work as many hours as may be reasonably necessary to fulfill [Taxpayer’s] obligations under this Agreement.
- 2) PAYMENT. **[Landowner] will compensate [Taxpayer] with a lump sum payment at the end of the project** as follows:
 - (a) All proceeds from the sale of each of the first two houses sold will go to [Landowner]. The net profit from the sale of the third house sold will go to [Taxpayer]. This amount will be calculated on the net amount of the sale minus 1/3 of the “construction costs” of the project. For the specific purposes of this project, “construction costs” include all costs related to the project including (but not limited to) permits, materials, contracted labor, accrued interest during holding period, marketing and sale of the properties: They specifically do not include [Taxpayer’s] labor or services, the actual cost or deemed value of the lots upon which the houses are built, or interest on funds used during the construction period.
 - (b) . . .
 - (c) Should the sale of all the houses not occur within 12 months from the date of the occupancy permit for the third and final house built in this project, and upon the request of [Taxpayer], [Landowner] will pay [Taxpayer] a lump sum of . . . per completed house

(Underlining and bolding added.) During the hearing, Taxpayer argued that notwithstanding the contract, both parties intended to create a joint venture and not a prime-contractor and owner relationship. Taxpayer pointed out that construction funds were kept in a joint bank account under both Taxpayer's and Landowner's name. Furthermore, both had check-signing authority. Taxpayer acknowledges, however, that Taxpayer was the only licensed contractor and that all building permits were issued in Taxpayer's name. Taxpayer also acknowledges that the subcontractors billed Taxpayer directly and that the lumber company account was in Taxpayer's name. Taxpayer was also not liable for any losses above and beyond the receipts from the sale of the houses. If construction costs exceeded sales receipts, Taxpayer would simply not be paid a share of profits.

Taxpayer and Landowner executed a similar . . . Agreement on . . . for [an additional project].

In support of its assertions, Taxpayer submitted copies of bank statements from the joint bank account . . . and check registers.

ANALYSIS

For Washington tax purposes, a joint venture is a separate "person" and each joint venture should be separately registered with the Department. RCW 82.04.030.

The "common law" principles expressed by Washington's courts have identified the elements of a joint venture:

The essential ingredients 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.

Gleason v. Metropolitan Mortgage, 15 Wn. App. 481, 493, 542 P. 2d 1260 (1976).

The courts have generally also included the requirement of sharing profits and 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)

Refrigeration Eng'r Co. v. Mckay, 4 Wn. App. 963, 973, 486 P. 2d 304 (1971).

And, where the parties engage in a joint enterprise and there is an agreement to share profits, the law will presume that they agreed to share losses also.

Skrivanich v. Davis, 29 Wn.2d 150, 186 P. 2d 364 (1947).

Applying the above essential ingredients and circumstances to Taxpayer's case, we believe that Taxpayer has failed to establish the existence of a joint venture or partnership. We have examined the Independent Contract Agreement . . . in effect during the audit period. Based on that agreement, we conclude that the agreement does not show that both parties intended to formulate a joint venture. On the contrary, the agreement clearly states that Landowner is hiring Taxpayer as a general contractor to perform and provide construction services in exchange for "a lump sum payment at the end of the project." Furthermore, a joint venture requires an equal right to voice accompanied by an equal right of control. This requirement is lacking in Taxpayer's agreement. The agreement clearly reserves control of the construction project to . . . Landowner and provides:

- A. [Landowner] is the owner of the property and the project and will have the deciding voice in all matters not related specifically to [Taxpayer's] technical expertise as a builder and contractor. This includes; (a) decisions which may affect overall costs, and (b) decisions regarding choice of colors and styles and such other matter that are influenced largely by personal taste.
- B. [Landowner] will provide the three lots to the proposed project. For the purposes of this project, the deemed value of each lot is
- C. [Landowner] will act as the interim lender for the proposed project and will pay all development and construction related costs. [Taxpayer] will provide a construction schedule with stipulated amounts advanced to [Taxpayer] for payment of sub-contractors and material providers. A joint project bank account will be opened to facilitate such transfers.

(Underlining added.) Finally, the agreement lacks the requirement for a sharing of both profits and losses. Although Taxpayer would be entitled to share in any profits of the project, Taxpayer indicated during the hearing that it would not have been liable for losses resulting from cost overruns exceeding the gross proceeds from the sale of the houses. Taxpayer would simply not receive any share of the expected profits, if there were losses.

To summarize, Taxpayer and Landowner lacked three of the five required elements of a joint venture. Their contract did not create a joint venture, they did not control the project equally, and they did not share profits and losses. Consequently, we conclude that the preponderance of evidence shows that Taxpayer and Landowner did not create a joint venture or partnership but had established an owner and prime contractor relationship. Therefore, Audit was correct in assessing Taxpayer as a prime contractor.

Moreover, even if Taxpayer and Landowner had created a joint venture, that would not alter the tax consequences. Receipts paid from a joint venture to a general contractor/member of the joint venture are exempt from taxation only if the payments are distributions of the member's share of profits. On the other hand, if a general contractor/member receives payment from a joint venture for constructions services rendered to the joint venture, the receipts are fully taxable. Det. No. 02-0123, 22 WTD 206 (2003). In Taxpayer's case, the agreement clearly states that Taxpayer has an absolute right to payment for its construction services. The agreement states that

Landowner will compensate Taxpayer for its construction services at the end of the project by paying the net profit of the third house to Taxpayer or if the third house is not sold within 12 months, \$. . . per completed house. Therefore, even if they had created a joint a venture, we would conclude that Taxpayer's receipts were compensation for construction services rendered to Landowner, rather than a distribution of profits. The result would be the same.

DECISION AND DISPOSITION

Taxpayer's petition is denied

Dated this 17th day of May, 2005.