Cite as Det No. 10-0062, 30 WTD 40 (2011)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 10-0062 Registration No. . . . Document No. . . ./Audit No. . . . Docket No. . . .

[1] Rule 170: SPECULATIVE BUILDER – ATTRIBUTES OF OWNERSHIP. A speculative builder is defined as a person who constructs buildings for sale or rental on land owned by the speculative builder. A construction company that builds on land purchased by the company's shareholders, paid for by the shareholders with financing guaranteed personally by the shareholders is not a speculative builder, because it is building on land owned by its shareholders and not on land that it owns.

[2] RCW 23B.02.030: FILING ARTICLES OF INCORPORATION PROOF OF CORPORATE EXISTENCE – SEPARATE ENTITY -- ALTER EGO. The corporate form is to be respected as a separate entity unless there is a showing that the corporate form was used to violate or evade a duty.

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.

Weaver, A.L.J. – A corporation in the construction business protests the assessment of retail sales tax and retailing business and occupation (B&O) tax by asserting that it was a speculative builder rather than a prime contractor constructing buildings on properties owned by its shareholders. We affirm the assessment.[1]

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

ISSUES

1. Whether a corporation that performs construction services on four properties owned by its shareholders is a "speculative builder" under WAC 458-20-170.

2. Whether a corporation that performs construction services on four properties owned by its shareholders is an "alter ego" of those shareholders and therefore should be disregarded.

FINDINGS OF FACT

[Taxpayer] is a construction company [which] had two shareholders ("Shareholders"), a married couple. Taxpayer was engaged in the business of building and renovating residential properties owned by its Shareholders. At the appeals hearing, Shareholders stated their reason for incorporating was to limit their personal liability for construction work performed by Taxpayer. . . . Shareholders registered Taxpayer with the Department as a construction contractor. Taxpayer employed between two and six employees. These employees were paid by Taxpayer and were managed by an experienced custom construction contractor ("Manager").

As is discussed in more detail below, Shareholders, either jointly or individually, purchased the following four properties: . . . None of these properties were purchased by Taxpayer. Taxpayer had an agreement with its construction Manager that any proceeds from the sale of the homes listed above would be split 50/50 between Taxpayer and Manager. This 50/50 split agreement is memorialized in notes provided by Taxpayer at the appeals hearing.

In addition to the four properties listed above, Taxpayer's Manager performed construction work on several other construction projects. Manager was authorized to purchase materials on Taxpayer's vendor accounts in conjunction with those custom construction jobs. While Taxpayer does not have contracts relating to these construction projects, Taxpayer identified the project expenses by job number in QuickBooks and booked the payments it received on those jobs as revenues.

Additional information and facts are listed below for each of the four construction jobs on the properties owned by Shareholders:

1. . . . Shareholders purchased a vacant lot for $. . . . This property was purchased by Shareholders prior to the date Taxpayer was incorporated. . . . Taxpayer's QuickBooks records indicate that the raw property was listed as an asset on the books. Taxpayer also booked a long-term liability associated with the land.

. . . One Shareholder, the husband, took out a bank loan for the purpose of constructing a single family residence on th[is] lot . . . . According to Taxpayer's QuickBooks records, eleven draws on Shareholder's loan totaling $. . . were deposited into Taxpayer's bank account [over a 10-month period]. These deposits were recorded as liabilities on Taxpayer's books.

Taxpayer recognized revenue only when the property sold. The amount of revenue was based upon the sale price of the real property. . . . The Shareholders, not Taxpayer, were listed as the seller on the sales documents.

2. . . . Shareholders purchased a single family home [and] a vacant lot next door. . . . Neither of these properties was purchased by Taxpayer.

However . . . Taxpayer's QuickBooks records list a journal entry showing both properties as one asset. There is a corresponding journal entry recording a long term liability associated with the properties. Once again, one Shareholder, the husband, took out a bank loan for purposes of constructing a multi-dwelling or duplex . . and [renovating] another multi-dwelling or duplex. . . . According to Taxpayer's QuickBooks records, nine draws on Shareholder's loan . . . were deposited into Taxpayer's bank account [over a 6-month period]. These deposits were recorded as liabilities on Taxpayer's books.

Taxpayer recognized revenue only when the properties sold. The amount of revenue was based upon the sale price of the real property. . . . Once again, the Shareholders, not Taxpayer, were listed as the seller on the sales documents.

4. . . . One Shareholder, the husband, purchased a single family home for . . . . Taxpayer's QuickBooks records indicate that the home was listed as an asset on the books. Taxpayer also booked a long-term liability associated with the land.

The Shareholder refinanced his personal home to finance the renovation of th[is] property. . . . No draws were deposited into Taxpayer's bank account. [The majority of the] expenses for work on the property . . . was paid by Shareholder personally. The remainder was paid by Taxpayer to complete renovation. All expenses were incurred [over a 27-month period]. The property . . . was sold. . . . The Shareholder, not Taxpayer, was listed as the seller on the sales documents.

The Audit Division of the Department of Revenue (Department) audited Taxpayer for the period of January 1, 2005, through December 31, 2007. Taxpayer did not file tax returns. The reason given by Shareholders at the hearing for Taxpayer's failure to file returns was they believed the work performed on the above listed properties qualified as speculative home construction.

After audit, the Audit Division found that Taxpayer was engaged in custom building services, rather than speculative building on the four listed properties and the construction jobs undertaken by Manager. The Audit Division found that Taxpayer was paying retail sales tax directly to the majority of its vendors and sub-contractors and granted Taxpayer a paid-at-source tax credit for all material and subcontractor purchases where the retail sales tax was paid at the time of purchase. After completing its audit, the Audit Division assessed Taxpayer $. . . in retail sales tax, $. . . in retailing business and occupation (B&O) tax, $. . . in delinquency penalties, $. . . in interest, and a $. . . assessment penalty, for a total of $. . . . Taxpayer filed a timely appeal.

ANALYSIS

[1] In general, a company that constructs, repairs, or improves new or existing buildings for consumers is required to collect retail sales tax from its consumers and pay retailing business and occupation (B&O) tax. RCW 82.04.050(2)(b), RCW 82.04.250, and RCW 82.08.020. Washington law distinguishes between speculative builders, or those that build on land owned by the builder, and prime contractors, or those that construct buildings or structures on real property "of or for consumers." WAC 458-20-170 (Rule 170). While speculative builders pay retail sales tax on materials they purchase and on all work performed by their subcontractors, prime contractors do not pay retail sales tax on such purchases, but must collect retail sales tax from their consumers on the "full contract price." Rule 170(4).

Taxpayer argues that it Audit improperly characterized Taxpayer as a prime contractor, and that it is properly characterized as a speculative builder. A "speculative builder" is defined as follows:

> (2) **Speculative builders.**
>
> (a) 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.

Rule 170(2). All four properties in this case were owned by Shareholders, either jointly or individually. The attributes of ownership confirm this. At the time of purchase, the listed purchaser of the properties was Shareholders, either jointly or individually. Shareholders paid for the land. Finally, the financing for the improvements to the land was secured and guaranteed by Shareholders personally. Taxpayer did not own the properties. The Department finds that Taxpayer performed construction services on properties owned by its Shareholders.

Rule 170(2) addresses the situation where a corporation performs construction services on land owned by its shareholders as follows:

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

170(2)(f). Because Taxpayer provided construction services on land owned by its Shareholders, Audit properly characterized Taxpayer as a prime contractor.[2]

[2] At the appeals hearing, Taxpayer raised the alternative argument that it was merely an alter ego of its Shareholders and should be disregarded. Taxpayer's position is because it was merely an alter ego of its Shareholders, the Shareholders effectively performed construction services on properties they themselves owned and are therefore "speculative builders." By filing its articles of incorporation, Taxpayer's corporate existence was conclusively proved. RCW 23B.02.030. A corporation is considered a separate entity which must be respected unless it is used to intentionally violate or evade a duty. *Dickens v. Alliance Analytical Labs., LLC*, 127 Wn. App. 433, 440, 111 P.3d 889, 892 (2005). Taxpayer's Shareholders stated that Taxpayer was incorporated to shield them from personal liability for the work done by the Taxpayer. Limited liability is the "corporation's most precious characteristic" and its existence is not reason for disregard the corporate form. *Equipto Div. Aurora Equp. Co v. Yarmouth*, 134 Wn.2d 356, 375, 950 P.2d 451, 460 (1998); *Truckweld Equipment Co., Inc. v. Olson*, 26 Wn. App. 638, 644, 618 P.2d 1017, 1021 (1980).

The Department has specifically addressed a similar alter ego argument in the speculative builder context, holding that the corporate form should be respected unless there is a showing that the corporate form was used to violate or evade a duty. Det. No. 89-252, 7 WTD 325 (1989) (citing *Molander v. Raugust-Mathwig, Inc*., 44 Wn. App. 53, 59 (1986)). There is no evidence in this case that Taxpayer's corporate form was used to violate or evade a duty. As was the case in 7 WTD 325, Taxpayer here kept books separate from Shareholders and filed separate federal income tax returns. *See* 7 WTD 325 at 5. The Department respects Taxpayer's corporate form and holds that it is liable for taxes assessed against it as a result of its performing custom building services on behalf of its Shareholders.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 24th day of February 2010.

[2] Taxpayer's argument on appeal is that it was a speculative builder and should be taxed accordingly. We note here that Taxpayer expensed material costs and received revenues for additional jobs that were not on the four properties owned by Shareholders. Taxpayer has no claim that it was a "speculative builder" with relation to these separate jobs. *See* Rule 170(2). For that reason, the assessments related to those jobs are affirmed.