

Cite as Det. No. 90-52, 9 WTD 085 (1990)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 93-269ER, 14 WTD 153 (1995).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of)	
)	No. 90-52
...)	
)	Registration No. ...
)	Document No. ...

- [1] RULE 109 AND RCW 82.04.4281: B&O TAX - INVESTMENT DEDUCTION - JOINT VENTURER/LIMITED PARTNER - BUSINESS ACTIVITY - DETERMINATION OF. For purposes of RCW 82.04.4281, mere financial participation in a project as a joint venturer/limited partner will not result in a taxpayer being considered to engage in the business activities conducted by the joint venture or partnership.
- [2] RULE 109 AND RCW 82.04.4281: B&O TAX - DEDUCTION - INVESTMENT - "FINANCIAL BUSINESS." A "financial business" is a business whose primary purpose and objective is to earn income through the handling and investment of a significant amount of funds, whose activities are essentially in competition with other financial businesses and are a regular part of the taxpayer's normal business practice. Sellen and Rainier Bancorporation cited.

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.

TAXPAYER REPRESENTED BY: ...

DATE OF HEARING: January 25, 1990

NATURE OF ACTION:

Petition concerning the taxability of money market and bank account interest received by a bank subsidiary which is involved in land development.

FACTS:

Bauer, A.L.J. -- The taxpayer's business records were examined for the period July 1, 1983 through December 31, 1986. The above-referenced assessment was issued on October 29, 1987 in the amount of \$. . . , including interest.

The taxpayer is a wholly-owned subsidiary of a savings bank. It was registered in July 1983, and stated its business as a "land developer." Its parent bank is precluded by banking laws from entering into a partnership or joint venture.

The taxpayer's representative explained that the taxpayer is involved in about ten partnerships/joint ventures which develop land, and owns some lots and projects.

The scenario usually goes as follows: The taxpayer meets with a developer who has a project in mind, and enters into either a partnership (limited) or joint venture with it by providing some capital to the venture. The partnership (or joint venture) then borrows additional capital from the taxpayer's parent bank. When profits are generated by the venture, the taxpayer receives a share of them.

Throughout the course of the taxpayer's existence, it has invested funds in a money market account and bank accounts.

The auditor concluded that, although the taxpayer had registered with the Department as a land developer, it had engaged in no such activity except as a partner in a joint venture subdividing and selling undeveloped land. The only business activity engaged in by the corporation itself has been that of making a funding loan to a related subsidiary and a second mortgage loan to the VISTA partnership.

Since the activities involved are essentially in competition with financial businesses and were the regular part of your only business practice, these activities constitute financial business and are subject to tax. In addition, those engaged in a financial business are taxable upon all interest received except for the deductions outlined in WAC 458-20-146. This schedule is assessing the tax on all interest earned during the audit period including interest earned from bank accounts and money market accounts.

TAXPAYER'S EXCEPTIONS:

The taxpayer contends that it is a "developer" and not a "financial business," and is therefore entitled to deduct interest income from the investment of its excess funds in money market and bank accounts.

ISSUES:

1. For purposes of determining whether a taxpayer is "engaging in banking, loan, security, or other financial businesses" for the passive income deduction of RCW 82.04.4281, can a taxpayer be deemed a "land developer" by investing in limited partnerships/joint ventures which develop land?
2. If the taxpayer is not a "land developer," is it a "financial business"?

DISCUSSION:

RCW 82.04.42812 provides in pertinent part as follows:

In computing tax there may be deducted from the measure of tax amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such...

Thus, if the taxpayer at issue is a "land developer" - instead of a "banking, loan, security, or other financial businesses" - passive investment income received from money market and bank accounts would be deductible under RCW 82.04.4281.

[1] To determine what business activities a taxpayer is engaged in for purposes of the passive income deduction of RCW 82.04.4281, we must look to the activities of that particular taxpayer, and not the activities of the entities in which it invests. Thus, mere financial participation in a project as a joint venturer/limited partner will not result in that taxpayer being considered to engage in the business activities conducted by those entities.

In this case, the taxpayer's representative summed up the taxpayer's activities in a post-hearing correspondence by stating:

...The financial statements clearly show that [the taxpayer] invested primarily in real estate partnerships, operating subsidiaries, and other real estate projects...

[Taxpayer letter dated January 25, 1990, emphasis added.]

We agree that the majority of the taxpayer's activities consisted of investing in limited partnerships and joint ventures - which in turn developed real estate. The taxpayer itself did not engage in the development of real estate. Only the individual joint ventures and partnerships, as entities, have engaged in (and can be taxed on) the business activity of developing land.

The question then becomes whether the taxpayer, being principally an investor on its own behalf, and which also made certain loans to the ventures in which it was involved, was entitled to the deduction for the investment of its excess funds in bank accounts and the money market. In other words, was it other than a "financial business." We think not.

A "financial business," for purposes of RCW 82.04.4281¹, which allows exemption from business and occupation taxes for investment income by persons other than financial businesses, is a business whose primary purpose and objective is to earn income through the handling and investment of a significant amount of funds. John H. Sellen Construction v. Department of Revenue, 87 Wn.2d 878, 882, 558 P.2d 1342 (1976) and Rainier Bancorporation v. Revenue, 96 Wn.2d 669, 672, 673, 638 P.2d 575 (1982). However, the Sellen court went on to quote with approval the following language of ETB 368.04.224 (June 12, 1970):

But it does not follow that every act of business or every investment and grant of the use of money is held to be financial business. . . . Where the activities involved are essentially in competition with financial businesses and this is a regular part of the taxpayer's normal business practice, the department believes that the activities constitute financial business.

[Emphasis added.]

[2] Thus, for purposes of RCW 82.04.4281, a "financial business" is a business whose primary purpose and objective is to earn income through the handling and investment of a significant amount of funds, where such activities are essentially in competition with other financial businesses and are a regular part of the taxpayer's normal business practice.

In this case, we think the taxpayer is in competition with other investors/businesses who have been formed and exist to provide financial backing to real estate development ventures for financial gain by becoming limited partners/joint venturers. Further, loans made to these entities were made in competition with banks who could have supplied the funds.

Thus, because the taxpayer's primary purpose and objective was to earn income through the handling and investment of a significant amount of funds in joint ventures and partnerships, and to a lesser extent to earn interest on loans to those ventures in which it was involved, and since its activities were in competition with other financial businesses and a regular part of its normal business practice, it must be considered to be a financial business. Accordingly, the deduction permitted by RCW 82.04.4281 for investment income must be denied.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 31st day of January 1990

¹ Formerly RCW 82.04.430(1)