Cite as Det No. 13-0076, 32 WTD 238 (2013)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 13-0076 Registration No. . . . Document No. . . . /Audit No. . . . Docket No. . . .

RULE 170: SPECULATIVE BUILDER – ATTRIBUTES OF OWNERSHIP. A speculative builder is a person who constructs buildings or structures on land it owns. A contractor that builds homes on land owned by a subsidiary is not a speculative builder.

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.

Chartoff, A.L.J. – A contractor (taxpayer) protests the assessment of retailing B&O tax and retail sales tax on unreported income received from its subsidiaries for construction services performed on land owned by the subsidiaries. The taxpayer argues it is the owner of the land under the attributes of ownership test in WAC 458-20-170 (Rule 170). Accordingly, the taxpayer asserts it is a speculative builder and does not owe retail sales tax on its own labor. We conclude the taxpayer is not the owner of the land under Rule 170, and deny the petition.

ISSUE

Did the contractor perform construction services on land it owns under WAC 458-20-170 and, therefore, it should be taxed as a speculative builder?

FINDINGS OF FACT

The taxpayer is a limited liability company (LLC) engaged in business in Washington State as a licensed construction contractor.

The taxpayer is the sole member of three Washington LLCs: . . . . The taxpayer is a majority member of a fourth Washington LLC: . . . . In this decision, we will refer to the four subsidiary LLCs collectively as "the subsidiaries." The taxpayer is the managing member of the subsidiaries.

Each subsidiary owns a separate housing development. The taxpayer formed the individual subsidiaries for the purpose of limiting the risk and liabilities from project to project.

When the taxpayer locates land for a possible development, it enters into a purchase and sale agreement with the seller. The taxpayer then does a feasibility study. If the taxpayer decides to go forward with the project, it forms a new subsidiary LLC and transfers the purchase and sale agreement to the subsidiary. The taxpayer also contributes capital and earnest money to the subsidiary to purchase the land.

The subsidiary then develops the property and sells the completed homes to buyers. To the extent there is bank financing for the construction, the subsidiary is the borrower and the taxpayer is a guarantor on the loan. During the audit period, the taxpayer began self-funding projects. On self-funded projects, the taxpayer contributes money to the subsidiaries to finance construction.

The subsidiaries are each licensed contractors. However, they have no employees. The subsidiaries hired subcontractors to perform most of the work. In addition, the taxpayer's employees provided construction supervision and labor to the subsidiaries. There is no written contract between the taxpayer and the subsidiaries for the construction services.

The taxpayer's books allocate the expense of providing construction supervision and laborers to the subsidiaries who receive the services. This amount is identified in the taxpayer's books as "payroll recovery" income.

The Audit Division of the Department of Revenue concluded that the payroll recovery receipts in the taxpayer's books are amounts received for construction services rendered to the subsidiaries. Accordingly, the Audit Division determined that retailing B&O tax and retail sales tax is due on this unreported income. The Audit Division issued an assessment of $. . . , consisting of $. . . in retail sales tax, $. . . in retailing B&O, $. . . in interest and $. . . in penalties. The assessment is for the period January 1, 2008, through June 30, 2011.

The taxpayer petitioned the Appeals Division of the Department for cancellation of the assessment. The taxpayer argues it is the owner of the land held by the subsidiaries, under the attributes of ownership test in WAC 458-20-170. Therefore, the taxpayer asserts it is a speculative builder and does not owe retail sales tax on its own labor.

ANALYSIS

The State of Washington imposes the Business and Occupation tax (B&O tax) for "the act or privilege of engaging in business activities" in this state. The rate and measure of the tax depend on the classification of the business activity engaged in.

Persons making sales at retail are taxable under the retailing classification for B&O tax measured by the gross proceeds of sales. RCW 82.04.250(1). Washington State also imposes a retail sales tax on retail sales in this state. RCW 82.08.020(1).

RCW 82.04.050(2)(b) defines the term "retail sale" to include, in pertinent part:

> [T]he sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to . . . . The constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers . . . .

RCW 82.04.190(4) defines "consumer" to include, in pertinent part: "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."

WAC 458-20-170(Rule 170) is the Department's administrative rule on the taxation of constructing and repairing of new or existing buildings or other structures upon real property. Rule 170(1)(a) defines the term "prime contractor" in pertinent part:

> The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing, repairing, decorating or improving of new or existing buildings or other structures under, upon or above real property, either for the entire work or for a specific portion thereof.

Prime contractors are taxable under the retailing classification upon the gross contract price. WAC 458-20-170(3)(a); RCW 82.04.050(2)(b); RCW 82.04.190(4). Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. Rule 170(4)(b).

A person engaged in the business of constructing homes on land it owns is a "speculative builder." Rule 170(2)(a). "Speculative builders are required to pay retail sales tax on all materials purchased by them and all charges made by their subcontractors." Rule 170(2)(e). This is because the speculative builder is the consumer of the materials purchased and charges made by the builder's subcontractors. Det. No. 08-0197, 28 WTD 076 (2009). However, speculative builders do not owe B&O tax or retail sales tax on the value of their own construction services. *Dep't of Revenue v. Nord Northwest Corp*, 164 Wn. App. 215, 225 (2011).

In the present case, there is no dispute that the subsidiaries held legal title to the real property on which construction was performed. The subsidiaries purchased the land and held legal title throughout construction. The subsidiaries entered into contracts with contractors for construction services. The subsidiaries entered into construction loans with banks to finance construction. The subsidiaries entered into purchase and sale contracts with the eventual buyers of the completed homes. Indeed, it was the intent of the taxpayer to divide the ownership of the developments into separate limited liability entities to limit the liability of each project. There is no dispute that the subsidiaries are the owners of the real property under Washington law.

The taxpayer, however, argues that it is a speculative builder under the attributes of ownership test in Rule 170(2)(a). Rule 170(2)(a) defines the term "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 Washington Court of Appeals recently explained in *Nord Northwest* that the attributes of ownership do not create an exception to the requirement that the speculative builder be the bona fide owner of the property. "Rather the attributes of ownership factors listed in WAC 458-20-170(2)(a) are relevant considerations only when necessary to distinguish actual ownership from a mortgage or similar security interest." *Nord*, 164 Wn. App. at 228. In the present case, there is clear, undisputed evidence that the subsidiaries were the bona fide owners of the real property, and there are no facts to suggest that the subsidiaries held only a security interest in the property. Because there is no dispute that the subsidiaries were the bona fide owners, the attributes of ownership are not applicable in this case.

It is well settled that affiliated entities are each a person within the meaning of Washington's Revenue Act. In general, transactions between them are fully subject to tax. *Nord*, 164 Wn. App. at 230; *Washington Sav-Mor Oil Co. v. State Tax Commission*, 58 Wn.2d 518, 364 P.2d 440 (1961); RCW 82.04.030; *See also* WAC 458-20-203 (regarding affiliated corporations); WAC 458-20-106 (regarding capital contributions). It is also settled law that a parent and subsidiary are generally treated as separate entities. *Nord*, 164 Wn. App. at 230; 28 WTD 076; Det No. 10-0062, 30 WTD 40 (2011). The attributes of ownership factors in Rule 170(2)(a) do not carve out an exception to the rule that each business entity is a separate taxpayer. *Nord*, 164 Wn. App. at 230. There is no legal basis in the record for disregarding the separate legal existence of the subsidiaries and treating the taxpayer as the owner of the subsidiaries' property.

The taxpayer argues that the *Nord* case is factually distinguishable from the present case and therefore does not apply. While there are factual differences between *Nord* and this case, the *Nord* decision clearly rejected the taxpayer's interpretation of Rule 170(2)(a). Therefore, the factual differences are not dispositive here.

In conclusion, we sustain the Audit Division's assessment of retailing B&O tax and retail sales tax on unreported revenues from providing construction services to the subsidiaries. We deny the taxpayer's claim that it performed the services as a speculative builder on land it owned.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 20th day of March 2013.