No. 44730-4-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

BRAVERN RESIDENTIAL II, LLC,

Plaintiff-Appellant

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Defendant-Respondent

ON APPEAL FROM Thurston COUNTY SUPERIOR COURT
(Hon. Gary R. Tabor)

APPELLANT'S OPENING BRIEF

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I. INTRODUCTION

Under Washington's tax code, the sales tax cost of forming a joint venture to construct a building is lower than the sales tax cost of hiring a general contractor to build the building. Consequently, the formation of a joint venture with a contractor is a "common way" to construct buildings in Washington. CP 488. Appellant Bravern Residential II, LLC ("Bravern II") is a joint venture that was formed in 2007 in accordance with longstanding DOR authorities to build a residential condominium tower in Bellevue in a tax-efficient manner.

The primary issue in this case is whether Bravern II meets the three requirements identified in DOR's Construction Guide for a joint venture to qualify as a "speculative builder," constructing the tower on the joint venture's own land through the capital contributions of a "contractor member." CP 488. If it does, then sales tax is still due on the materials and subcontract labor incorporated into the building, but no sales tax is due on the value of the contractor member's contributed labor. The requirements in DOR's Construction Guide for a joint venture to qualify as a speculative builder are: (1) "a joint venture entity must actually exist"; (2) "the joint venture entity must own the land"; and (3) the contractor member of the joint venture cannot be "guaranteed a fixed amount as compensation for construction services." CP 488.

The undisputed facts establish that Bravern II satisfies all three requirements: (1) Bravern II actually exists, CP 43, 53; (2) Bravern II owns the land on which it built the condominium tower, CP 49; and (3) the members' Operating Agreement is unequivocal: "No Member shall be entitled to any guaranteed payment." CP 64. The trial court erred in failing to conclude that Bravern II meets the requirements in DOR's Construction Guide for a joint venture to qualify as a speculative builder.

In its cross-motion, DOR argued in the alternative that a statute enacted in 2010, RCW 82.32.655, retroactively authorized DOR to "disregard" Bravern II's 2007 arrangement. However, RCW 82.32.660 expressly prohibits DOR from applying RCW 82.32.665 to arrangements that were entered into in accordance with published DOR guidance, such as DOR's Construction Guide and the published DOR Determinations on which the Construction Guide is based. Moreover, DOR's argument is contrary to the plain language of RCW 82.32.655, which expressly limits DOR's new taxing authority to specifically defined types of arrangements. Bravern II does not fall within the statutory definition. Finally, even if the statute were construed to permit retroactive taxation of Bravern II, such construction would be unconstitutional.

II. ASSIGNMENT OF ERROR

Bravern II makes the following assignment of error:

1.The Superior Court erred in denying Bravern II's summary judgment motion and granting DOR's motion. CP 655.

III. ISSUES PRESENTED

1. Whether Bravern II meets the three requirements for a joint venture to qualify as a speculative builder, constructing a building on the joint venture's own land through the capital contributions of its members.

2. Whether RCW 82.32.655 retroactively authorized DOR to disregard Bravern II's qualification as a speculative builder when:

   a. RCW 82.32.660 prohibits DOR from applying RCW 82.32.655 where, as here, the arrangement was entered into before the statute was enacted and conforms to published DOR guidance such as the Construction Guide;

   b. Bravern II does not satisfy the either the form or substance requirements set forth in RCW 82.32.655; and

   c. Retroactive application of RCW 82.32.655 would be unconstitutional.

IV. STATEMENT OF THE CASE

A. Statement of Facts.

Bravern II is a joint venture between Bravern Residential Mezz II, LLC ("BRM") and PCL Construction Services, Inc. ("PCL"), formed to build a residential condominium tower known as Signature Residences at The Bravern, Tower 4 ("Tower 4").[1] CP 49, 627. As its name implies, Tower 4 is one of a group of buildings in a larger complex known as The Bravern, located in downtown Bellevue. The other buildings in the Bravern complex were built by joint ventures with the same organizational structure. The Bravern, LLC ("The Bravern") was the joint venture formed to build the retail building, two office towers (Towers 1 and 2), and a parking garage in the complex. Bravern Residential I, LLC ("Bravern I") was formed to build another residential condominium tower known as Signature Residences at The Bravern, Tower 3. CP 310-312.

The Bravern, Bravern I, and Bravern II are identically structured, with each utilizing the same structure that had been long used by "a number of Washington's largest construction companies" and property developers. CP 392. For many years, similarly structured joint ventures had routinely

[1] BRM and PCL are unrelated parties who were each represented by their own counsel in the formation of Bravern II. BRM was represented by Marc Kretschmer of Fikso Kretschmer Smith Dixon PS and PCL was represented by Robin Thaxton Parkinson from the Law Offices of Robin Thaxton Parkinson.

received DOR letter rulings confirming that the joint venture qualified as a speculative builder under DOR's published guidance. CP 317 (a "Construction JV Ruling"). In fact, PCL, Bravern II's construction member, specifically sought out membership in Bravern II because of PCL's experience with similarly structured joint ventures that had received Construction JV Rulings dating back to at least 1999. CP 335-336.

Bravern II satisfied the first requirement for a joint venture to be a speculative builder—that "a joint venture entity must actually exist"—by filing a certificate of formation with the Secretary of State, CP 43, and entering into a written Operating Agreement between its Members. CP 53. Bravern II satisfied the second requirement for a joint venture to be a speculative builder—that "the joint venture entity must own the land"—by obtaining deeded title to the land on which it built Tower 4. CP 49. Bravern II satisfied the third requirement for a joint venture to be a speculative builder—that the contractor member cannot be "guaranteed a fixed amount as compensation for construction services"—by its Operating Agreement, which expressly prohibits any member from receiving any guaranteed payments. Paragraph 3.5 of the Operating Agreement provides:

> **3.5 No Guaranteed Payments**. No Member shall be entitled to any guaranteed payments from the Company, whether within the meaning of IRC Section 707(c) or otherwise.

CP 64.

DOR's Construction Guide explains that when these three requirements are satisfied, "the joint venture is a speculative builder. In this case the work performed by the contractor is a contribution to the capital of the joint venture." CP 488. Consistent with DOR's Construction Guide, paragraph 2.2.4 of the Operating Agreement specifically provides for PCL, as the construction member, to "make periodic contributions of services and materials" to Bravern II "for which it shall receive credits to its capital account." CP 62. A contribution of capital in exchange for an adjustment to a member's capital account is not a sale and therefore not subject to sales tax. WAC 458-20-106(5) ("Transfers of capital assets to a partnership or joint venture in exchange for an interest in the partnership or joint venture" are "not taxable").

Separately, the Operating Agreement permitted Bravern II, at the discretion of its managing member and subject to the availability of Cash Available for Distribution (a defined term in the Operating Agreement), to make discretionary capital redemptions. CP 63. Pursuant to the Operating Agreement, discretionary distributions of Cash Available for Distribution constituted a "partial return of capital" that reduced the recipient member's capital account. *Id.* As with capital contributions, redemptions of capital are not taxable events. WAC 458-20-106(5) ("Transfers of capital assets . . . by a partnership or joint venture to its members in

exchange for a proportional reduction of the transferee's interest in the partnership or joint venture" are "not taxable").

Qualification of a joint venture as a speculative builder does not, of course, exempt the joint venture from taxation. DOR's Construction Guide explains that when a joint venture qualifies as a speculative builder, constructing a building on the joint venture's own land through the capital contributions of its members, sales tax is due "on materials purchased or produced for incorporation into the real estate." CP 488. "Additionally, sales or use tax must be paid on services provided by third-party subcontractors." CP 319 (Construction JV Ruling).

Here, $7,911,180 of sales tax was paid on materials and subcontractor labor incorporated into Tower 4 during its construction. CP 628. Bravern II does not dispute that such tax was properly due. Indeed, Bravern II's status as a speculative builder only excluded the value of the labor performed by PCL as part of its capital contribution to Bravern II from the measure of sales tax paid on the construction of Tower 4. DOR has long recognized this tax treatment through its Construction Guide and numerous favorable rulings approving identically structured joint ventures as speculative builders, including The Bravern.

B. Procedural History.

The Bravern received a letter ruling confirming that The Bravern would be taxed as a speculative builder on August 24, 2007. CP 398. Bravern II submitted an identical ruling request just three days later on August 27, 2007. CP 403. Bravern II, however, was the victim of bad timing. In the spring of 2007 (at the height of the construction boom), DOR became concerned about a perceived increase in the volume of requests for the Construction JV Ruling and desired to cease issuing them.[2]

Recognizing that its existing guidance, including the Construction Guide, on which the Construction JV Ruling was based was "insufficient" to deny requests submitted by properly structured joint ventures like Bravern II (CP 388), DOR decided to commence a stakeholder process "in order to develop additional guidance" that could be used to support denials of such requests. CP 391. DOR's Director informed the Governor that, because DOR had approved "a number of requests" in "past years," as a matter of "both fairness and consistency," DOR would "continue to approve requests that are similar to those already approved" until new standards were established. CP 391.

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[2] DOR does not track ruling requests and, consequently, is unable to determine how many Construction JV Rulings it issued to similarly structured joint ventures. CP 384.

However, after commencing the stakeholder process, DOR changed its position. Rather than approving Bravern II's request as it had The Bravern's, an internal email indicates that DOR decided it would "neither approve[] nor den[y]" pending requests until completion of the stakeholder process. CP 414. DOR changed its position yet again, and in November 2007 (before the second stakeholder meeting) decided to deny ***all*** requests for Construction JV Rulings submitted after August 24, 2007, which denials would "clearly set[] out the Department's legal position." CP 417.

However, it took another three months for DOR to formally deny Bravern II's request. On February 29, 2008, DOR circulated "DRAFT Proposed Guidance" for "general input" at the third stakeholder meeting scheduled for March 26, 2008. CP 428. That same day, February 29, 2008, DOR issued its denial of Bravern II's ruling request, CP 420, which denial—instead of "clearly setting out the Department's legal position"—was simply cut-and-pasted verbatim from the DRAFT Proposed Guidance DOR had simultaneously circulated to stakeholders for comment. CP 425.[3] The DRAFT Proposed Guidance, however, never went beyond the draft stage and was never adopted. CP 426. On September 25, 2008, DOR terminated the stakeholder process, advising stakeholders that it

[3] *Compare* the Bravern II Denial, CP 420-422, *with* the DRAFT Proposed Guidance, CP 432-433.

would "not be issuing additional written guidance" but "instead" would "rely on [existing] published determinations . . . to provide guidance on this issue." CP 439. DOR did not do that; instead, it disregarded the guidance set forth in its Construction Guide.

Bravern II filed an administrative appeal of DOR's denial of its ruling request, which appeal was denied on April 29, 2009. CP 441. Bravern II sought reconsideration, which was denied on April 8, 2010. Because Washington law provides no mechanism for obtaining direct judicial review of the denial of a ruling request, *Booker Auction Co. v. DOR*, 158 Wn. App. 84, 88-89, 241 P.3d 439 (2010), Bravern II paid $107,842.10 in tax on a discretionary distribution made to its construction member and brought this refund action in order to obtain judicial review of DOR's denial of Bravern II's request for a Construction JV Ruling. CP 4.

On cross-motions for summary judgment, the Superior Court denied Bravern II's motion and granted DOR's without explanation of the basis for its ruling. CP 654. This appeal followed.

V. ARGUMENT

A. The Superior Court erred in denying Bravern II's summary judgment motion because Bravern II meets all three requirements for a joint venture to qualify as a speculative builder.

1. Speculative builders are not subject to sales tax on the value of their own labor.

Washington's sales tax only applies to "retail sales," which are defined by statute to include the sale of construction labor performed by one "person" on land owned by another "person." RCW 82.04.050(2)(b). However, construction labor performed on a person's own land is outside the statutory definition of a retail sale and, therefore, is not subject to tax. *Rigby v. State*, 49 Wn.2d 707, 710-11, 306 P.2d 216 (1957). DOR refers to a "person" who builds on that person's own land as a "speculative builder." WAC 458-20-170(2)(a), CP 17.

Qualification as a "speculative builder" has a significant impact on the sales tax costs of constructing a building. When a contactor sells construction services to a landowner, no sales tax is due on the contractor's purchases of materials and third party subcontractor labor (because those are wholesale transactions)[4] with the sales tax being due instead on the entire amount the contractor charges the landowner. WAC

[4] WAC 458-20-170(4)(c).

458-20-170(4)(a); *see also Klickitat County v. Jenner*, 15 Wn.2d 373, 382, 130 P,2d 880 (1942). The result is that sales tax is ultimately paid not just on the construction materials and subcontract labor, but also on the labor performed by the contractor.

In contrast, when a contractor makes a capital contribution of construction services to a joint venture that is a speculative builder, sales tax is still due on the materials and subcontract labor purchased by the contractor in its capacity as member but is not due on the contractor's contributed labor. WAC 458-20-170(2)(e); CP 488 (Construction Guide), CP 319 (Construction JV Ruling). Thus, by forming a joint venture to construct the building, the value of the contractor member's labor is excluded from the sales tax base, while sales tax continues to be paid on the value of the materials and subcontract labor used in the project.

In summary, the sales tax cost of hiring a contractor to construct a building is higher than the sales tax cost of forming a joint venture with a contractor because the value of the labor is treated as an untaxed capital contribution rather than a sale of construction services.

2. DOR's Construction Guide identifies the requirements for a joint venture to be a speculative builder.

As DOR acknowledges in its Construction Guide, the formation of a joint venture with a contractor "is a common way to accomplish the

development of real estate." CP 488. Consistent with the principles discussed above, DOR's Construction Guide explains: "When a joint venture owns the land and the contractor performs construction services as a member of the joint venture . . . the joint venture is a speculative builder" and "the work performed by the contractor is a contribution to the capital of the joint venture." *Id.* Contributions of capital are not subject to sales tax. WAC 458-20-106(5).

DOR's Construction Guide identifies the three requirements long established in its Excise Tax Advisories ("ETAs") and published Washington Tax Determinations ("WTDs") that define when a joint venture qualifies as a speculative builder. First, "the joint venture entity must actually exist." CP 488. Second, "the joint venture entity must own the land." *Id.* Third, the members cannot "be guaranteed a fixed amount as compensation for construction services." *Id.*

Bravern II, like the similarly structured joint ventures to whom DOR had been issuing Construction JV Rulings for years, meets all three of these requirements. Consequently, Bravern II is not subject to sales tax on the value of construction services contributed to by its contractor member and is entitled to a refund of the tax it paid in order to obtain judicial review of DOR's denial of its ruling request.

3. Bravern II meets the first requirement—it actually exists.

The first requirement for a joint venture to qualify as a speculative builder is that "a joint venture entity must actually exist." CP 488. While this requirement may seem obvious, DOR has faced numerous instances in which taxpayers have claimed construction joint venture treatment when there was no evidence that a joint venture entity had actually been formed. For example, in Det. No. 88-14, 5 WTD 19 (1988),[5] a construction company argued that it had formed a joint venture with the owner of three lots on which the company had built homes, even though the joint venture agreement was not entered into until after "the homes had already been completed." 5 WTD at 20. Under those facts, DOR held that there had been no joint venture entity in existence when the homes were being built. 5 WTD at 23. Similarly, in Det. No. 90-108, 9 WTD 231 (1990), the "issue [was] whether joint ventures existed." DOR declined to apply joint venture treatment to an alleged joint venture logging operation where "the lack of evidence . . . fails to support the taxpayer's contention that joint ventures existed." 9 WTD at 237.

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[5] Washington Tax Determinations are available on DOR's website at http://taxpedia.dor.wa.gov.

In contrast, in Det. No. 99-108, 19 WTD 143 (2001), DOR "found the taxpayers created a valid joint venture" for the publication of telephone directories existed by virtue of the parties' execution of a written agreement. Because the joint venture existed, distributions to the members were not subject to tax. 19 WTD at 151. Similarly, in Det. No. 87-254, 3 WTD 431 (1987), DOR recognized the joint venture actually existed where the existence of the joint venture was established by a written agreement.

In the present case, the undisputed facts establish that the joint venture entity, Bravern II, actually exists. The record includes Bravern II's certificate of formation (CP 43) as well as its Operating Agreement. CP 53. Moreover, both in its administrative determination and again on reconsideration, DOR specifically acknowledged the existence of the joint venture entity, defining Bravern II as the "Joint Venture" and noting that "the rights and responsibilities of the parties to the Joint Venture are set forth in an Operating Agreement signed by both members." CP 226, 257. The undisputed facts thus unequivocally establish the first requirement—"that a joint venture entity actually exists."

a. DOR's contention that Bravern II is not a joint venture because it has a managing member was both untimely and erroneous.

Notwithstanding the undisputed evidence and DOR's prior express acknowledgement that Bravern II is a joint venture, DOR argued for the

first time near the end of its reply brief in Superior Court that Bravern II "is not a joint venture" because the Operating Agreement appoints BRM as "Managing Member," CP 637-638, a proposition for which DOR cited no authority.[6] In addition to being untimely[7], the contention is legally wrong.

While it is basic black letter law that joint venture members "must have an equal right to a voice in the manner of its performance and an equal right of control over the agencies used in its performance," it is well settled that providing for one of the members to be the managing member does ***not*** violate that requirement; one co-venturer "may intrust the performance to the other or others" without affecting the legal status of the joint venture. *Bates v. Tirk*, 177 Wash. 286, 292-93, 31 P.2d 525 (1934); *Keisel v. Bredick*, 192 Wash. 665, 668, 74 P.2d 473 (1937) (same); *Duvall v. Pioneer Sand & Gravel Co.*, 191 Wash. 417, 421, 71 P.2d 567 (1937) (same); *De Nune v. Tibbitts*, 192 Wash. 279, 286, 73 P.2d 521 (1937) (same); 48A C.J.S. Joint Ventures § 11 ("The rights of the parties with respect to the management and control of the venture may be fixed by agreement so as to shift control, and each joint venturer need not exercise

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[6] It is unclear whether this factored into the Superior Court's ruling. However, at oral argument, the Judge described the primary issue in the case as "whether or not this is a joint venture." 6/7/13 Hearing Tr. at 3.

[7] *White v. Kent Medical Center, Inc., P.S.*, 61 Wn. App.163, 168, 810 P.2d 4 (1991) ("the rule is well settled that the court will not consider issued raised for the first time in a reply brief").

actual physical control of the instrumentalities used in the enterprise."). Thus, in *Fiorito v. Goerig*, 27 Wn.2d 615, 617-18, 179 P.2d 316 (1947), the status of a joint venture formed in order to "construct certain utilities for three housing projects" was unaffected by the fact that one of the members "under the joint venture agreement was to have the management and the responsibility of the operations of the joint venture."

Not only is DOR's position legally wrong, it is also entirely inconsistent with its construction joint venture rulings. In fact, in the Construction JV Rulings DOR granted to similarly structured joint ventures, DOR expressly recognized that one member of the joint venture "will be the managing member." CP 318. Like those other approved ruling requests, the request submitted by Bravern II in August 2007 expressly noted that BRM would be the managing member (CP 212) and provided DOR a copy of the Operating Agreement. To the extent the Superior Court based its ruling on this incorrect, inconsistent, and untimely argument, it erred as a matter of law.

4. Bravern II meets the second requirement—it owns the land on which it built Tower 4.

The second requirement for establishing that a joint venture is a speculative builder is that "the joint venture must own the land." CP 488 (Construction Guide at 12). In the present case, it is undisputed that

Bravern II owns the land on which it built Tower 4. CP 49 (Deed). Indeed, DOR concedes "there is no dispute that Bravern II owned the land upon which Tower 4 was built." CP 19. Thus, the undisputed evidence establishes that Bravern II meets the second requirement.

As explained in WAC 458-20-170(2)(f), "joint ventures . . . who perform construction upon land owned by their . . . co-venturers[] are constructing upon land owned by others" and, therefore, do not qualify as speculative builders. Thus, for instance, in Det. No. 88-199, 5 WTD 373 (1988), a joint venture formed to build a house was not a speculative builder because one of the joint venture's members (a trust) was the owner of the property on which the house was built, rather than the joint venture itself. 5 WTD at 378 ("the construction and sale were not done by the joint venture as a speculative builder. The trust alone owned the property."). [8]

[8] Though it did not involve a joint venture, a similar result was reached in *Dept. of Revenue v. Nord Northwest Corp.*, 164 Wn. App. 215, 264 P.3d 259 (2011), *review denied*, 173 Wn.2d 1019 (2012). In that case, "Nord entered into construction contracts with" two entities that owned property in Bellingham and Stanwood respectively, pursuant to which those entities "paid Nord for its construction services." 164 Wn. App. at 221. Despite conceding that "we don't own the property," *id* at 226, Nord argued that it should be treated ***as if*** it owned the land based on certain "attributes of ownership" mentioned in WAC 458-20-170(2)(a). *Id.* at 224. The Court rejected this argument, holding that "the attributes of owners 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." *Id.* at 228.

In contrast, when a joint venture itself (rather than one of its members) owns title in the land on which the joint venture constructs a building, then the joint venture is engaged in speculative building. Thus, in Det. No. 97-189, 17 WTD 148 (1998), DOR held that distributions from a joint venture to its members were not subject to tax because the joint venture was the "owner, possessor and consumer of the real property upon which the condominiums were built." 17 WTD at 154. Bravern II satisfies the second element of a speculative builder as the undisputed owner of the land on which it constructed Tower 4.

5. Bravern II meets the third requirement—no member is entitled to any guaranteed payments; all distributions were discretionary, conditioned on availability of cash, and were non-taxable redemptions of capital.

The third requirement for a joint venture to be a speculative builder is that the contractor member cannot be entitled to any "guaranteed payments as compensation for construction services." CP 488. DOR's ETAs and WTDs generally describe this requirement as a prohibition against "absolute" payments to members, which DOR defines as a right to payment "that is 'without relation to or dependence on other things or persons.'" Det. No. 89-290, 8 WTD 1 (1989) (*quoting* Black's Law Dictionary, Fifth Edition, 1979); *accord* Det. No. 99-176, 19 WTD 456 (2000) (whether distributions were "absolute payments that were payable

to them in any event"); Det. No. 90-74, 9 WTD 143 (1990) (whether there is an "obligation" to pay that is "'absolute' or fixed"); and Det. No. 87-254, 3 WTD 431 (1987) (a distribution is "'absolute,' and therefore taxable when it is payable in any event" (quoting Excise Tax Bulletin 073.08.106 (1966), *reissued as* Excise Tax Advisory 3136 (2009)).

Thus, in Det. No. 05-0104, 26 WTD 1, 4-5 (2007), DOR held that a member had an absolute right to payment for its construction services contributed to the joint venture because the agreement provided that "Landowner ***will*** compensate Taxpayer for its construction services at the end of the project." (Emphasis added.) In contrast, in Det. No. 99-176 19 WTD 456 (2000), DOR held that all of the requirements for a joint venture to be a speculative builder were satisfied, emphasizing that the third element was satisfied because "distributions to the taxpayers were not absolute payments that were payable in any event." 19 WTD at 461.

Here, it is also undisputed that distributions to members are not payable in any event without relation to other events or persons. Under the joint venture's Operating Agreement, any distributions to members are expressly conditioned upon Cash Available for Distribution (a defined term in the Operating Agreement) and can only be distributed at the discretion of the Managing Member. Bravern II is under no obligation to make distributions:

> **3.2 Periodic Distributions of Cash Available for Distribution.** Cash Available for Distribution ***may*** be distributed periodically to either Member as determined by Managing Member. Without limiting the foregoing, in the case of BRM, the Company ***may*** periodically distribute Cash Available for Distribution to repay Member Loans or as a partial return of capital. If at any time PCL's Unreturned Capital Contribution Amount exceeds one percent (1%) of the Unreturned Capital Contribution Amount of all Members, then the Company ***may*** make a distribution PCL in an amount necessary to cause PCL's Unreturned Capital Contribution Amount to equal one percent (1%) of the Unreturned Capital Contribution Amount to equal one percent (1%) of the Unreturned Capital Contribution Amount of all Members.
>
> . . .
>
> **3.5 No Guaranteed Payments.** ***No member shall be entitled to any guaranteed payment*** from the Company, whether within the meaning of IRC Section 707(c) or otherwise.

CP 63-64 (emphasis added). Thus, not only does the Operating Agreement specifically prohibit guaranteed distributions, it expressly conditions any distributions on the availability of Cash Available for Distribution—and even then, distributions are only made at the discretion of the Managing Member. Therefore, Bravern II's distributions are not absolute, guaranteed, or fixed in accordance with DOR's Construction Guide, published determinations, and tax advisories. Presumably that is why DOR's internal memo described its published guidance as "insufficient" to deny requests for Construction JV Rulings when explaining the need for DOR to establish "additional guidance" through a stakeholder process—in other words, to change the rules.

Because Bravern II—like similarly structured joint ventures who received a Construction JV Ruling in the past—meets the three requirements in DOR's Construction Guide, Bravern II built Tower 4 on Bravern II's own land through the capital contributions of its members as member. Thus, Bravern II is not subject to sales tax on the capital contributions of labor by its contractor member. Rather, the nearly $8 million of sales tax paid on the materials and subcontract labor incorporated into Tower 4 is all the tax that was properly due, and Bravern II is entitled to a refund of the $107,8742.10 of tax it paid to obtain judicial review of this matter. The Court should reverse the trial court and enter an order in Bravern II's favor.

B. DOR's denial of Bravern II's 2007 ruling request was not retroactively authorized by the 2010 enactment of RCW 82.32.655.

Near the end of its summary judgment motion, DOR made the alternative argument that its denial of Bravern II's August 27, 2007 letter ruling request can be justified "under RCW 82.32.655" (CP 25), a new tax statute that was not enacted until 2010, nearly three years ***after*** Bravern II submitted its request for a Construction JV Ruling and by which time Tower 4 was nearly complete. Laws of 2010, 1st Sp. Sess. Ch. 23, §201. Neither DOR's February 29, 2008 denial of Bravern II's ruling request (CP 221), nor DOR's April 29, 2009 administrative determination

affirming the denial (CP 225), nor DOR's April 8, 2010 reconsideration decision (CP 240) make any reference to RCW 82.32.655 because the statute did not even exist when any of those actions were taken.

In any event, a companion statute completely ignored by DOR, RCW 82.32.660, expressly precludes DOR from retroactively applying RCW 82.32.655 to Bravern II because, like other similarly structured joint ventures that received a Construction JV Ruling, the arrangement conforms to the requirements established by DOR's published documents. Additionally, the plain language of RCW 82.32.655 simply does not apply to Bravern II. Regardless, even if (1) RCW 82.32.660 did not expressly preclude DOR from applying RCW 82.32.655 to Bravern II, and (2) Bravern II actually fell within the statutory requirements of RCW 82.32.655(3)(a), retroactive application of the new tax statute would nevertheless be unconstitutional.

1. RCW 82.32.660 prohibits DOR from applying RCW 82.32.655 to Bravern II because Bravern II reported tax in conformance with published DOR guidance.

RCW 82.32.660 expressly prohibits DOR from applying RCW 82.32.655 where a taxpayer entered into the arrangement before the enactment of RCW 82.32.655 in conformance with published DOR guidance, such as the Construction Guide:

> The department ***may not*** use RCW 82.32.655 to ***disregard any transaction or arrangement initiated before May 1, 2010***, if, in respect to such transaction or arrangement, the taxpayer had reported its tax liability ***in conformance with*** either specific written instructions provided by the department to the taxpayer, ***a determination*** published under the authority of RCW 82.32.410, ***or other document made available by the department to the general public***.

RCW 82.32.660(1)(a). As discussed above, Bravern II was formed in 2007 in accordance with publically available DOR guidance, including DOR's Construction Guide, which sets out the standards DOR has been applying for nearly half a century in numerous published determinations and tax advisories.[9] DOR's published guidance provides that a joint venture builds on its own land through the capital contributions of its members when (1) the joint venture entity actually exists, (2) the joint venture own the land, and (3) members are not guaranteed a fixed amount as compensation for construction services. CP 488. As discussed in Section A above, all three requirements are satisfied.

Because Bravern II was formed before May 1, 2010 in accordance with the publicly issued standards in DOR's Construction Guide and related published documents (ETAs and WTDs), DOR is specifically

[9] All of those published documents remain publically available and none of them have been repealed or reversed. In fact, the oldest of those published documents, Excise Tax Bulletin 073.08.106, was reissued without change in 2009 (Excise Tax Advisory 3136.2009), and the Joint Venture section of DOR's Construction Guide remains unchanged despite more than 68 other revisions to the Guide between 2006 and 2012. CP 466.

prohibited by RCW 82.32.660(1)(a) from invoking RCW 82.32.655 to retroactively justify its denial of Bravern II's August 27, 2007 request for a Construction JV Ruling.

2. Bravern II does not fall within RCW 82.32.655's expressly defined arrangements that DOR became authorized in 2010 to disregard.

When interpreting a statute, courts must begin with the plain language of the words actually used by the Legislature. *HomeStreet, Inc. v. Dept. of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009). In doing so, a court "is required to assume the Legislature meant exactly what it said and apply the statute as written." *Id.* at 451-52. "[I]f the statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent." *State Owned Forests v. Sutherland*, 124 Wn. App. 400, 409, 101 P.3d 880 (2004). If "any doubt exists as to the meaning of a taxation statute, the statute must be construed most strongly against the taxing power and in favor of the taxpayer." *Agrilink Foods, Inc. v. Department of Revenue*, 153 Wn.2d 395, 396, 103 P.3d 1226 (2005).

Enacted April 23, 2010, RCW 82.32.655 granted DOR new authority to "disregard . . . transactions or arrangements that are described in subsection (3)." Although DOR contends that Bravern II falls within section (3)(a), it ignores most of the statutory language defining the

relevant type of arrangements that DOR has been newly authorized to "disregard." Section (3)(a) is limited to:

> Arrangements that are, [1] ***in form***, a joint venture or similar arrangement between [a] a construction contractor ***and*** [b] the owner or developer of a construction project but that are, [2] ***in substance***, substantially guaranteed payments for the purchase of construction services ***characterized by a failure of the parties' agreement to provide for*** [a] the contractor to share substantial profits ***and*** [b] bear significant risk of loss in the venture.

RCW 82.32.655(3)(a) (bracketed numbering and emphasis added). The plain language of the statute thus imposes two requirements for an arrangement to be eligible to be disregarded under subsection (3)(a) arrangements. First, the arrangement must have a statutorily defined "form" (a joint venture in which one of the members is the owner or developer of a construction project). Second, the arrangement must have a statutorily defined "substance" (the parties' agreement must "fail[] to provide" for the parties to share substantial profits and must also fail to provide for the parties to bear significant risk of loss).

"It is an axiom of statutory interpretation that where a term is defined, [the court] will use that definition." *U.S. v. Hoffman,* 154 Wn.2d 730, 741, 116 P.3d 999 (2005). Under the express terms of the statute, for DOR to disregard a joint venture as a speculative builder, the parties'

agreement must satisfy the statutory definition by failing to provide for ***both of*** two things:

(a) the contractor member to "share substantial profits"; ***and***

(b) the contractor member to "bear significant risk of loss."

RCW 82.32.655(3)(a). It is well-settled that the use of the word "and" in a statute is conjunctive. *Ahten v. Barnes*, 158 Wn. App. 343, 353 n.5, 242 P.3d 35 (2010). Therefore, all of the above form and substance requirements must be met for an arrangement to fall within the statute. The undisputed facts demonstrate that Bravern II does not meet either the form or the substance required by the statute.

a. Bravern II does not meet the form required by RCW 82.32.655(3)(a) because BRM is not "the owner or developer of a construction project."

Arrangements covered by RCW 82.32.655(3)(a) must be "in the form of a joint venture" between two specified types of members: (1) a construction contractor "***and***" (2) "the owner or developer of a construction project." While one of Bravern II's members, PCL, is a construction contractor, its other member, BRM, is ***not*** "the owner or developer of a construction project." As discussed in Section A.2 above, DOR concedes that Bravern II, not BRM, is the owner of the land on which Bravern II built Tower 4. Moreover, DOR did not assert that BRM is the "developer of a construction project" and certainly did not present

any evidence on the issue. The undisputed evidence in the record unequivocally shows that Bravern II, ***not*** BRM, is the developer of the construction project. CP 625. Because BRM is neither the owner nor the developer of Tower 4, Bravern II does not fall within the form required by the plain language of RCW 82.32.655(3)(a). Therefore, RCW 82.32.655 cannot be invoked to retroactively justify DOR's denial of Bravern II's August 27, 2007 request for a Construction JV Ruling.

b. Bravern II does not meet the substance required by RCW 82.32.655(3)(a) because: (i) the Operating Agreement provides for the parties to share substantial profits; and (ii) the Operating Agreement provides for the parties to bear significant risk of loss.

Even if Bravern II had met the "form" expressly required by RCW 82.32.655(3)(a), the plain language of the statute ***also*** requires a specific "substance" to the arrangement, which the statute defines by reference to the parties' agreement. Specifically, the statute requires that the parties' agreement must ***fail to provide*** for "the contractor to share substantial profits" ***and*** must also ***fail to provide*** for the contractor member to "bear significant risk of loss." RCW 82.32.655(3)(a) (emphasis added).

In the present case, the parties' agreement—the Operating Agreement—expressly ***provides for*** the contractor member, PCL, to "share substantial profits" and also provides for PCL to "bear significant

risk of loss." Specifically, paragraph 10.3.1 of the Operating Agreement provides for all members to share profits "in proportion to their Percentage Interests until the aggregated amount allocated pursuant to Section 4.1.1(d) and Section 10.3.1(d) is $17,258,520." CP 76. There can be no question that $17.2 million would be a "substantial" profit. Because the Operating Agreement ***does not*** "fail[] to provide" for the members to "share substantial profits," Bravern II does not fall within the arrangements defined in RCW 82.32.655(3)(a).

Separately and additionally, Bravern II does not fall within the arrangements defined in RCW 82.32.655(3)(a) because the Operating Agreement also expressly provides for the members to bear significant risk of loss. Similar to the agreement's provisions for sharing the substantial profits that had been hoped for at the outset of the venture (before the unanticipated collapse of the real estate market), the parties' agreement expressly provided for the members to bear the risk of loss of their respective capital contributions. Specifically, Paragraphs 4.1.2 and 10.3.2 both provide for losses to be allocated to the members, including PCL, to the extent of their capital accounts, and for losses exceeding the amounts of their capital accounts "to the Members in proportion to their Percentage Interests." CP 64-65, 77. Thus, the parties' agreement provides for both members, including PCL, to bear the risk of loss—not

just of their entire capital accounts, but also for any losses incurred by Bravern II in excess of the parties' capital. For instance, from June 2008 through June 2010, the average month-end balance of PCL's capital account was $6,759,296. If Bravern II had failed during that time (as many other projects in the region did), PCL's loss would have been significant. Because the Operating Agreement ***does not*** "fail[] to provide" for significant risk of loss, this is not an arrangement DOR became authorized to disregard in 2010 when RCW 82.32.655 was enacted.

3. Retroactive application of RCW 82.32.655 would be unconstitutional.

Even if Bravern II could qualify as the type of arrangement defined in RCW 82.32.655(3)(a), and even if RCW 82.32.660 did not prohibit DOR from using RCW 82.32.655 to "disregard" Bravern II, retroactive application of the new tax statute enacted in 2010 to an arrangement structured in 2007 would be unconstitutional. The U.S. Supreme Court has expressly held that a new tax "cannot be imposed retroactively." *U.S. v. Carlton*, 512 U.S. 26, 38, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994) (citing *U.S. v. Hemme*, 476 U.S. 558, 568, 106 S. Ct. 2071, 90 L. Ed. 2d 538 (1986)). Following controlling U.S. Supreme Court case law, the Washington Supreme Court has likewise held that retroactive application of a new tax law is unconstitutional. *In re McGrath's Estate*, 191 Wash. 496,

509-10, 71 P.2d 395 (1937) (retroactive application of a new estate tax law unconstitutional). And in *Bates v. McLeod*, 11 Wn.2d 648, 657, 120 P.2d 472 (1941), the Court again held that the retroactive imposition of a new tax was unconstitutional. In *Bates*, the attempted period of retroactivity was only three months; the new tax was enacted on March 16, with an effective date of January 1 of that same year. *Id.* at 655-56. The court found the contributions to be a new tax and refused to allow the State to impose the new tax retroactively to earlier that same year. *Id.* at 657.

RCW 82.32.655 was a new tax. Prior to the enactment of RCW 82.32.655, there was no provision authorizing DOR to impose tax by disregarding taxpayers' contracts. To the contrary, the Washington Supreme Court has expressly required DOR to administer tax in accordance with the parties' contracts in the absence of a statute authorizing otherwise. *Weyerhauser Co. v. Dep't of Revenue*, 106 Wn.2d 557, 566, 723 P.2d 1141 (1986) ("We hold that, where an installment contract does not provide for interest, the Department of Revenue may not impute such interest without specific statutory or regulatory authority").

Even if (1) RCW 82.32.660 did not expressly prohibit DOR from disregarding Bravern II's arrangement, and (2) Bravern II were an arrangement defined in RCW 82.32.655(3)(a), the specific statutory

authority to impose tax in "disregard" of the arrangement is a new tax whose retroactive application would be constitutionally prohibited.

VI. CONCLUSION

Bravern II satisfies all three requirements of a speculative builder constructing Tower 4 on its own land through the capital contributions of its members. Therefore, Bravern II respectfully requests that the Court of Appeals reverse the Superior Court's order and instruct the Superior Court to enter judgment in favor of Bravern II on its tax refund claim in the amount of $107,842.10 plus interest thereon.

RESPECTFULLY SUBMITTED this 20th day of September, 2013.

LANE POWELL PC

By _____

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury of the laws of the State of Washington, that on September 20, 2013, I caused to be served a copy of the foregoing on the following persons in the manner indicated below at the following addresses:

Mr. Charles E. Zalesky Ms. Rosann Fitzpatrick Office of the Attorney General of Washington Revenue Division 7141 Cleanwater Drive SW PO Box 40123 Olympia, WA 98504-0123 JulieJ@atg.wa.gov ChuckZ@atg.wa.gov Rosannf@atg.wa.gov CandyZ@atg.wa.gov	☑ by **Electronic Mail** ☐ by **Facsimile** ☐ by **First Class Mail** ☐ by **Hand Delivery** ☐ by **Overnight Delivery**

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Linda Mitchell