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IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

GARY STOWE and DOUGLAS TAYLOR, d/b/a TS DESIGN,

Appellants,

v.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Respondent.

APPELLANTS' REPLY BRIEF

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I. SUMMARY OF REPLY

The real estate excise tax and the interpretative regulations adopted by the Department of Regulations are valid, as no court has declared otherwise. The Department of Revenue ("DOR") incorrectly argues that its own regulation should be ignored when imposing Washington State retail sales tax. Washington law supports taxation based on the substance of a transaction; if taxation were based solely upon the identity of the deed holder, then it would not be necessary for DOR regulations to provide guidelines as to the attributes of ownership.

Moreover, scholars and the majority of recent court decisions agree that "injustice is more apt to be avoided by giving effect to the oral partnership agreement ... rather than by refusing enforcement under the statute of frauds." CORBIN ON CONTRACTS ("CORBIN") § 17.12, p. 465 (1997). DOR incorrectly claims that an oral contribution of land to a joint venture by one of the joint venturers is not a valid transaction, and that its position is the majority one. DOR wants the benefit of equitable rules of ownership when it is beneficial to the assessment of revenue—such as ignoring legal title when the substance of the transaction is between a debtor and a creditor—while ignoring equitable doctrines when they support the taxpayer, as is the case here. Similarly, DOR takes inconsistent positions regarding the applicability of partnership law, seeking to apply select provisions while ignoring the well-established validity of oral

agreements, and the purpose of promoting justice which underlies both partnership law and the statute of frauds.

II. LEGAL ARGUMENT

A. STATUTES AND REGULATIONS ARE VALID UNLESS AND UNTIL A COURT HOLDS OTHERWISE.

DOR argues that this court should not apply WAC 458-20-170 ("rule 170"), *its own retail sales tax regulation*, because the issue was not raised below. Brief of Respondent, p. 32. DOR is wrong: Rule 170 was cited by both parties in the summary judgment proceedings. The regulation was discussed at length in DOR's original motion for summary judgment. CP 201-208. In addition, subsection (2)(a), regarding the attributes of ownership, was specifically discussed by DOR in its brief. CP 207-208. In addition, TS Design referred to the regulation in its response brief. CP 232-34. Finally, DOR mentioned the regulation in its reply brief. CP 266, 273.

Moreover, Rule 170 remains valid unless DOR persuades a court that it lacked authority to declare the rule, or adopted it improperly:

> A reviewing court may declare a rule invalid only if (1) the rule violates constitutional provisions; (2) the rule exceeds the agency's statutory authority; (3) the rule's adoption did not comply with statutory rule-making procedures; or (4) the rule is arbitrary and capricious.

Association of Washington Business v. State, Dept. of Revenue, 121 Wn. App. 766, 769-70, 90 P.3d 1128 (2004) (*citing, inter alia*, RCW 34.05.570(2)(c). Thus, DOR's argument that this Court should not consider or apply Rule 170 has no legal basis.

B. LEGAL TITLE IS NOT THE EXCLUSIVE MEANS OF DETERMINING OWNERSHIP.

Washington law, including the excise tax statutes and regulations, demonstrate that holding record title is not the exclusive means of determining ownership of real property. If legal title were the exclusive means of determining ownership, it would not be necessary to evaluate the attributes of ownership relevant to the imposition of a particular tax. Both the statutes imposing excise tax in Washington and the regulations applying the statutes establish that tax should be imposed based on the substance of a transaction rather than its form.

1. Washington State Excise Tax Statutes Support Taking a Broad View of Transfers of Ownership.

Washington law defines a retail sale to include transfers of ownership "by title, possession, or any other means." RCW 82.04.050(c) (emphasis added). This statute imposes a retail excise tax on a prime contractor's sale of a newly constructed home when the home is built on the consumer's property, and is relied upon by DOR in this case. Not only does this statute refer to transfers of real property "by title, possession, or any other means," thereby supporting the Appellants' claim that a land owner may contribute property to a joint venture without a formal transfer of title, but the exception set forth in subsection (c) of this statute also supports the Appellants' claim when it states that a retail sale includes transfers by means other than a transfer of title.

The general rule is that the sale of property, on which the owner has constructed a new home, is not a retail sale. Subsection (c) of

RCW 82.04.050 provides an exception to this general rule when an owner conveys property to a contractor during construction, and the property is then reconveyed "to the original owner." RCW 82.04.050(c). The exception is obviously intended to impose tax based on the *substance* of a transaction, rather than its pretext.

In this case, the *substance* of the transaction was the joint venture's sale of a newly constructed home to Mr. and Mrs. Hilterbrant. In light of the stipulated facts -- for purposes of summary judgment -- that one of the joint venturers contributed land to a joint venture and that the joint venture built a new home on this land which was then sold to the Hilterbrants, the trial court erred in holding that the sale should be taxed as a custom home rather than a home built on speculation.

2. Department of Revenue Rules Also Support Taking a Broad View of Transfers of Ownership.

Similarly, DOR's interpretative regulation supports TS Design's position, and reversal of the order granting summary judgment. That DOR's own regulation finds it necessary to define the attributes of ownership argues against a simple pro forma application of the tax based upon the identity of the deed holder of record. As noted in TS Design's opening brief (and not denied), DOR acknowledged this fact in a prior case. *See White-Leasure Development Company v. Dep't of Revenue*, Board of Tax Appeals No. 55226 (2001) (quoting DOR's position that a taxpayer without legal title is a custom builder <u>unless</u> construction was

performed as part of a joint venture between the taxpayer and the title holder).

Statutes are not to be construed so as to render language superfluous. *Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 273, 59 P.3d 655 (2002) (*citing Fray v. Spokane County*, 134 Wn.2d 637, 648, 952 P.2d 601 (1998)). Thus, presumably, the decision whether to impose a real estate excise tax and at what level to charge a retail sales tax should be determined based on the substance of a transaction, and the characteristics of a speculative builder "include but are not limited to" the attributes of ownership suggested in the DOR regulation.

3. The Attributes of Ownership Support Appellants' Claim that the Joint Venture Sold the Property at Issue.

Rule 170 suggests several nonexclusive means of assessing the substance of a transaction, for purposes of determining whether a taxpayer is a speculative builder or is building a custom home. These include the intentions of the parties who acquire and pay for the land and improvements, and the manner in which all parties deal with the land. WAC 458-20-170(2).

In the summary judgment motion, DOR conceded that land was contributed to a joint venture, so it is the joint venture. Thus, it is the joint venture and its members whose intentions are at issue. DOR misses this key point and instead asks such unhelpful questions as 'when the joint venturer who contributed the property acquired it in the first place,' and

'what were the venturer's intentions at that time?' See, e.g., Brief of Respondents, p. 28.

The appropriate analysis of the joint venture's acquisition of the property and sale to the Hilterbrants evaluates (1) the purpose *of the joint venture* to which one of its members contributed the property; (2) whether *the joint venture* paid for the land; (3) whether *the joint venture* paid for the improvements to the land; and (4) whether all parties dealt with the land as though it belonged to the joint venture. WAC 458-20-170(2).

Here, TS Design produced evidence that land was contributed to a joint venture for purposes of building a home on speculation; that the parties intended from the outset to build a speculative home for sale to a third party; and that the venturers would divide the net profits.

Moreover, the venturers followed through on their intentions. It is undisputed that the joint venture paid for both the land and the improvements prior to dividing the profit.

Therefore, both the statutes and the regulations interpreting them support the appellants' claim that the existence of a conveyance by deed is neither a necessary nor conclusive means of determining ownership, for purposes of assessing the appropriate tax.

C. THE STATUTE OF FRAUDS DOES NOT APPLY TO A JOINT VENTURE AGREEMENT TO DEVELOP AND SELL LAND TO A THIRD PARTY.

Scholars, as well as courts across the country, have come to various conclusions as to when and in what circumstances the statute of

frauds applies to oral joint venture or partnership agreements, depending on the nature of the disputed conveyance. Contrary to DOR's claim, the current majority rule is that the statute of frauds does not apply to the oral agreement to contribute property to a joint venture.

1. No Formal Conveyance is Necessary to Contribute Property to a Joint Venture.

The majority of courts that have analyzed oral joint venture agreements involving property have concluded that agreements such as the one at issue here are valid and enforceable. For example, in one line of California cases, the parties agreed to share profits from rent or sale of real property, and one party failed to account to the others. *Kaljian v. Menezes*, 36 Cal. App.4th 573, 583, 42 Cal. Rptr.2d 510 (Cal. 5 Dist. 1995) (citing cases). In these cases, the agreement was was not within the statute of frauds and an oral agreement to convey property was enforceable. *Id.* In other cases, parties acquired property for their joint account, but one took title in his own name; in such cases, the oral agreement is again enforceable. *Id.* at 583-85.

In yet another group of cases, most relevant to the joint venture at issue here,

> an owner of real property orally agrees to contribute it to a joint venture which, in turn, would operate or sell it. The oral promise was enforceable because creation of the joint venture had the effect of vesting title to the property in the entity, **making a formal conveyance unnecessary**.

Kaljian, 36 Cal. App.4th at 584 (internal citations omitted) (emphasis added). The *Kaljian* court distinguishes each of these situations from a

conveyance between partners or joint venturers. In such a case, when one venturer has orally agreed to convey property to another, the purpose of the transaction is not an undertaking for profit, but rather a direct transfer of real estate, and the statute of frauds is directly implicated. *Id.* at 584-86.

The leading treatise, Corbin on Contracts, reaches the same conclusion by distinguishing between four types of conveyances: from a partnership to a third party; from a partner to the partnership; from one partner to another; and from the partnership to a partner. 4 Caroline N. Brown, CORBIN ON CONTRACTS,§ 17.12, p. 465-69. CORBIN agrees with the Uniform Partnership Act that injustice is more likely avoided by honoring oral agreements in a partnership or joint venture context, and concludes that the only situation that requires application of the statute of frauds is when the dispute involves a conveyance from one member of a joint venture to another. *Id.* Conversely, in the case of a partner's contribution of property to a partnership, the agreement falls within the Uniform Partnership Act's acknowledgement of oral and informal partnership agreements. *Id.* at 467.

Many of the earlier cases involving oral partnerships and joint ventures were decided prior to the Uniform Partnership Act (adopted in Washington in 1945) and prior to its revision (adopted in Washington in 1998), which has resulted in a shift in the majority rule:

> Today, in light of the diminishing influence of the statute of frauds as well as the guidance provided by a good deal of caselaw and commentary generated by the almost unanimous adoption of the [Uniform Partnership Act] by

> the states, it appears less necessary to encumber partnership transactions with statute of frauds formalities.

CORBIN, p. 467, n. 13.

Corbin's approach is consistent with Washington law, "the substance of a transaction between partners should control, rather than its form," *Id.* at 468. DOR's approach ignores both state law and its own regulations by requiring that tax be applied based on the record title holder, disregarding the oral joint venture agreement.

DOR is also mistaken that partnership law supports its position, rather than that of appellants. Brief of Respondents, p. 15. The evidence shows that one member of the joint venture contributed the land and advanced the costs of construction, and that the joint venture paid for all of the costs of both land and labor prior to distributing any profit. See, e.g., CP 237-246. Under the Revised Uniform Partnership Act, because the joint venture paid for both the land and the house, its ownership is presumed. RCW 25.05.065.

2. The Cases Cited by DOR Do Not Support Its Position.

The cases cited by DOR do not support its attempt to avoid the well-settled rules that an oral agreement to develop land for speculation and divide the profits is valid and enforceable and that the extent of the partners' interest may be shown by parol evidence.

DOR acknowledges that the Washington decisions it cites are not on point with this case. Respondent's Brief, p. 18. For example, DOR cites a decision in 1894, which involved the speculative purchase by four

people of land in Seattle for sale as city lots. Brief of Respondents, p. 18, citing *Brewer v. Cropp*, 10 Wash. 136 (1894). After the plaintiff in *Brewer* had paid development costs, he claimed his partners were supposed to convey the property to him, but failed to do so. Thus, the substance of the dispute was an individual's claim that his partners failed to convey to him their interest in jointly held property – a disputed oral agreement to convey property *between partners*. DOR is correct that in situations such as that in *Brewer*, the majority rule continues to be that the oral agreement was not properly binding. "While the real estate owned by the partnership is regarded as personal property for some purposes, it is an equitable conversion only, and the requirements of the law relating to conveyances of land must be observed in disposing of it." *Brewer,* 10 Wash. at 138. In other words, while partners have equitable ownership in property during its development by a partnership, a transfer to only one of the partners must be by deed. This case does not support DOR's argument that the general rule regarding oral joint venture agreements "does not extend to the sale or transfer of real estate ... between a partner and the partnership" but that a deed is required. Brief of Respondent, at 17-18 (citing *Brewer* and *King v. Northern Pac. R. Co.*, 27 Wn.2d 250, 177 P.2d 714 (1947)).

In the second case relied upon by DOR, the court again addressed a situation in which three persons acquired land for a logging operation; one to contribute a donkey and sawmill, the second a tractor, and the third a truck and timber. *King*, 27 Wn.2d at 252. Two of the men claimed the third had sold his interest in the partnership, which included his interest in

the real property. *Id.* at 255. The appellate court acknowledged that in some circumstances the assets of joint venturers were to be treated as personal property, such that a deed was not required to convey land. *Id.* at 258. However, the court distinguished situations in which the intent of a transaction is to vest property in an individual member of the joint venture, in which case the statute of frauds did apply. *Id.* at 258-59. Thus, where the oral agreement involves a profit-making venture, such as a subsequent sale of the property, "*[t]he purpose is not to finally vest title in the partners according to their several interests.*" *Id.* at 259 (italics in original). The *King* decision demonstrates that in 1947, as today, the Washington court recognized that it is the substance of the oral agreement that should determine its validity.

DOR attempts to avoid this fact by arguing that the well-settled rule that a joint venturer's real property interest need not be in writing does not apply to conveyances from one partner to another, Brief of Respondent, p. 17. However, that issue is not presented here.

The sole case that arguably supports DOR's position is a Vermont decision which involved "a protracted dispute between a former couple over the assets of their alleged partnership in a horse farm business." *Quimby v. Myers*, 895 A.2d 128, 179 Vt. 611 (2005) (cited in Brief of Respondents, p. 19). Quimby claimed a one-half interest in property held by his former romantic partner, Myers, who held sole legal title to the property until she transferred it to herself and her new husband. *Quimby*, 895 A.2d at 130-31. Although the court ruled that the alleged conveyance

of real property to a partnership was subject to the statute of frauds, the ultimate dispute was once again between individual partners, a situation that CORBIN agrees should remain within the safeguards of the statute of frauds.

The final case relied upon by DOR is a 1963 New York case, in which the court actually supported CORBIN's position. Brief of Respondent, p. 20 (citing *Backus Plywood Corp. v. Commercial Decal, Inc.*, 317 F.2d 339, 342 (C.A.N.Y. 1963)). The *Backus* court confirmed that the statute of frauds did not apply

> to joint ventures to make purchases from or transact business with third parties. ... But the label 'joint venture' will not remove the bar of the statute when, as here, **the very essence of the asserted venture is a sale from one 'venturer' to the other.**

Backus, 317 F.2d at 342 (citations omitted) (emphasis added). This comment is consistent with the approach actually taken by the majority of courts and scholars seeking to reconcile the law of partnerships and joint ventures and the statute of frauds.

3. DOR's Arguments Fail to Address the Essence of the Joint Venture Agreement and Sale to the Hilterbrants.

DOR attempts to portray the dispute at issue as the validity of the contribution of land to the joint venture, which it claims without authority (and erroneously) is equivalent to a transfer from one venturer to another. Brief of Respondents, at 18. In fact, the taxable transaction at issue is actually the joint venture's sale to the Hilterbrants, pursuant to an oral joint venture agreement to develop land and share in the profit from a sale

to a third party. The essence of this case is *not* "an oral agreement to convey land between parties to the business venture," *DOR,* at 19 (emphasis added). The case is about the contribution of property and labor to a joint venture pursuant to an agreement *to convey the property to a third party* for the mutual profit of the joint venturers.

The evidence supports Appellants' position regarding the nature of the joint venture agreement and the sale to the Hilterbrants. Not only do the closing documents from the sale to the Hilterbrants list the joint venturers as Seller, but as DOR acknowledges, it is joint venturers who did not hold record title who received and distributed the proceeds of that sale. Brief of Respondents, p. 7, n. 5 (citing the evidence of TS Design's payment to Staatz Bulb Farms from the sale proceeds). Contrary to DOR's suggestion, (Brief of Respondents p. 5, citing Declaration of Douglas Taylor, CP 238) a decision to apply profits from a joint venture to a further venture does not negate the original agreement, or relate to the nature of the joint venture's sale to the Hilterbrants.

Nor is it relevant whether a partnership or joint venture was formed for the purpose of acquiring land or whether the land contributed was already owned by one of the members; "the difference between an agreement to convey an interest in land and an agreement to enter into a partnership concerning land is subtle at best." CORBIN, at 467 (quoting 1 Alan R. Bromberg & Larry E. Ribstein, BROMBERG & RIBSTEIN ON PARTNERSHIP § 3.06 at 3:92 (1994)). Holding the statute of frauds inapplicable in either situation is consistent with the historical practice of

holding partnership property in the name of one partner without a formal conveyance to the partnership. *Id.* (citing BROMBERG & RIBSTEIN at 3:15.) Overall, "injustice is more apt to be avoided by giving effect to the oral partnership agreement ... rather than by refusing enforcement under the statute of frauds." *Id.* at 465.

DOR is also incorrect that the members of the joint venture "conceded" a lack of ownership. Brief of Respondents, p. 13. What appellants actually conceded was that legal title was not transferred until the sale to the Hilterbrants. CP 129, 172. Taylor went on to explain that in his view, while Staatz Bulb Farm had conveyed the property, and TS Design had conveyed the house. CP 129. Thus, "the joint venture owned the whole thing as a land/home package, which turned around and sold it to Lauren and Gerard Hilterbrant." CP 131. Taylor did not believe that a deed was required for the land to be contributed to a joint venture. CP 130. Washington law, Corbin, and the Revised Uniform Partnership Act agree with Taylor.

III. CONCLUSION

The real estate excise tax and the interpretative regulations adopted by the Department of Revenue are valid, as no court has declared otherwise and DOR is incorrect that they were not cited in the summary judgment proceedings. It is a long-standing and unrefuted rule that laws imposing tax are to be construed most strongly in favor of the taxpayer. *Qwest Corp. v. City of Bellevue*, 161 Wn.2d 353, 364, 166 P.3d 667

(2007) (citations omitted). Here, the statutory language supports Appellants' position that the level at which a retail sales tax is imposed is determined by the substance of the transaction at issue. Moreover, scholars and the majority of recent court decisions agree that "injustice is more apt to be avoided by giving effect to the oral partnership agreement ... rather than by refusing enforcement under the statute of frauds." CORBIN, §17.12, p. 465.

For all of these reasons, the trial court erred in ruling as a matter of law that Appellants should not be taxed as speculative builders, but as builders of a custom home for Staatz Bulb Farm. Appellants therefore ask that the Order Granting Summary Judgment be reversed.

DATED this 21st of February, 2008.

Respectfully submitted,

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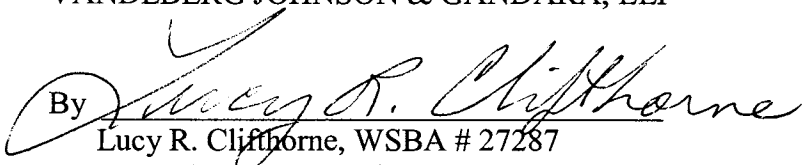
By 

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I hereby certify that on the 21st day of February, 2008, I caused the foregoing Appellants' Reply Brief to be served on the following counsel of record via fax and mail:

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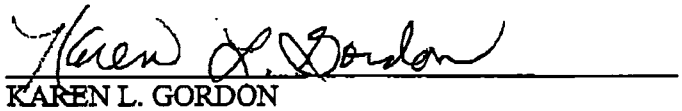

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