

Repeal shared real estate commission B&O tax exemption

- Description** This proposal would repeal the B&O tax exemption for shared real estate commissions. This would result in the taxation of real estate commissions as follows.
- A real estate firm would pay B&O tax on its gross commissions from real estate sales, including the portion of commissions paid to brokers (i.e., sales persons) associated with the firm or to a cooperating real estate firm on a particular transaction.
 - Real estate brokers would pay B&O tax on their own gross commissions.
 - Cooperating real estate firms would pay B&O tax on their own share of commissions.

See pages 2-3 for an example that illustrates this proposal and how it differs from current law.

- Current law** The B&O tax generally “pyramids” -- it is imposed on several taxpayers when there are multiple transactions with respect to the same goods or services. However, an exception exists for real estate commissions.
- Under RCW 82.04.255, B&O tax is paid on the gross commissions received by a real estate firm, including that portion of the commission paid to salespersons on a particular transaction.
 - If the real estate firm pays its B&O tax liability, the salespersons associated with the firm do not have to pay B&O tax on their share of commissions.
 - When a commission is split between a listing firm and a cooperating firm, each firm pays B&O tax only on its respective share of the commission.
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- Important background** RCW 82.04.255 became effective July 1, 1970. Prior to that date, the Department had long allowed real estate brokerage offices to deduct from gross income, for B&O tax purposes, the portion of commissions paid to salespersons. In 1968, the Department changed its position on the taxation of real estate commissions and denied a deduction to brokerage offices for the portion of commissions paid to salespersons. Litigation ensued, and the
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Important Background (continued)

Department's position was rejected by the courts. *See Davenport, Inc. v. Dep't of Revenue*, 6 Wn. App. 581 (1972).

The *Davenport* decision is based on the rationale that: (1) B&O tax is imposed on "persons" as defined in RCW 82.04.030; (2) a "person" as defined in that statute includes "any group of individuals acting as a unit"; (3) real estate brokerage offices consist of a group of individuals acting as a unit; and (4) therefore, B&O tax applies only once to each commission.

The *Davenport* decision must be taken into account in drafting any legislation to implement this proposal. It is not enough to simply repeal RCW 82.04.255. The definition of "person" in RCW 82.04.030 should be amended to make clear that non-employee salespersons associated with a brokerage office are separate "persons" for B&O tax purposes.

It should also be noted that the real estate licensing laws were updated effective July 1, 2010. One of the changes to these laws was to replace the term "real estate salesperson" with "broker" and establishes that the broker is the entry level licensee. Brokers perform real estate brokerage services for "real estate firms" under the supervision of a "designated broker" or "managing broker."

Example to illustrate the proposal

The following example illustrates this proposal. A real estate firm representing a seller (the "listing firm") receives a commission of \$10,000 on the sale of the seller's home. The listing firm splits the commission 50/50 with the real estate firm representing the buyer (the "cooperating firm"). Both the listing firm and cooperating firm share half of their portion of the commission with the seller's and buyer's agents.

Under current law - B&O tax applies as follows:

- The listing firm owes B&O tax on \$5,000.
- The cooperating firm owes B&O tax on \$5,000 (their respective shares of the commission).
- Neither the seller's nor the buyer's agents owe any B&O tax on their share of the commission.

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Example to illustrate the proposal
 (continued)

Under this proposal - B&O tax would instead apply as follows:

- The listing firm would owe B&O tax on its \$10,000 commission.
- The cooperating firm would owe B&O tax on \$5,000 (its share of the \$10,000 commission split equally with the listing firm).
- The seller’s agent would owe B&O tax on the \$2,500 in commission received from the listing firm.
- The buyer’s agent would owe B&O tax on the \$2,500 in commission received from the cooperating firm.

Revenue Impact

General Fund Impacts (\$ millions):

# of Impacted Taxpayers	FY 2016	FY 2017	2015-17 Biennium	FY 2018	FY 2019
8,600	\$ -	\$ 34.7	\$ 34.7	\$ 39.3	\$ 40.3

Notes:

- Estimates assume a July 1, 2016 effective date, representing 11 months of collections for FY 2017.
- Estimates reflect the November 2015 Economic & Revenue Forecast Council revenue forecast.

Expenditure Impact

FY 2016	FY 2017	2015-17 Biennium	FY 2018	FY 2019	2017-19 Biennium
\$ 20,100	\$ 109,000	\$ 129,100	\$ 93,600	\$ 92,400	\$ 186,000