

Cite as Det. No. 91-310, 11 WTD 505 (1992).

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 the Prior Determination)	
of Tax Liability)	No. 91-310
)	
. . .)	Registration No. . . .
)	
)	
)	

[1] RULE 162 -- GROSS INCOME -- FACTORING. Losses from factoring business may be used to offset gains incurred in the same month to arrive at gross income which is taxed at the service rate. See Det. No. 89-474, 8 WTD 259 (1989).

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: . . .

NATURE OF ACTION:

The taxpayer requests a prior determination of tax liability regarding factoring transactions between it and a subsidiary to be formed.

FACTS AND ISSUES:

Free, A.L.J. -- The taxpayer is a Washington corporation It purchases goods with its affiliates for resale from manufacturers and suppliers. Many of those vendors do not require immediate payment with due dates up to 90 days following the date of purchase.

The taxpayer proposes forming a subsidiary corporation headquartered in Washington for the purpose of engaging in the factoring business. The subsidiary would approach various vendors and purchase the receivables payable by the taxpayer or

its affiliates and other non-related entities. The subsidiary would pay the vendors discounted prices for the receivables.

For instance, a \$1,000 receivable due in 90 days might be purchased for \$900. The subsidiary might hold the receivable until the due date and collect the \$1,000 from the taxpayer realizing a \$100 gain. Or it might resell it for 95% (\$950) of value and only realize a \$50 gain. If sold for less than \$900, it would realize a loss.

The taxpayer presents the following questions:

1. For the purpose of the Washington business and occupation tax (B & O tax), how is "gross income of the business" computed when the business is a factoring business, that is, is the gross income of the business the gross amount received when the debtor pays the amount owed to the subsidiary on the account receivable (or when the receivable is resold), or is the gross income the amount received when the subsidiary resells the receivable or collects from the debtor, reduced by the subsidiary's cost basis in the account receivable?
2. Does the answer to question No. 1 change if the receivable is collected from the obligor (debtor) on the receivable, or instead the receivable is sold to a third party?
3. May losses from factoring be offset against factoring gains and, if so, must this be done on a monthly basis as required by WAC 458-20-162, or instead may it occur on an annual basis corresponding to the taxpayer's tax year?
4. If WAC 458-20-162 applies, and if the net factoring income for a particular month results in a net loss, may that net loss be applied against the net gain of a different month within the same year to reduce the net gain or create a net loss?
5. Since WAC 458-20-162 literally only applies to stockbrokers and security houses, may a factor compute the gains and losses from factoring (i.e., amount realized less cost basis) on a yearly basis, instead of on a monthly basis, assuming the gross proceeds of the business means the net gains and net loss (i.e., amount realized less cost basis)?
6. What is the current rate at which the B&O tax is imposed on factoring income?

The taxpayer argues that losses can be used to offset gains on an annual basis.

DISCUSSION:

RCW 82.04.080 defines "Gross income of the business" as:

. . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses. (Emphasis supplied.)

The receivables are other evidence of indebtedness. Gains realized from trading evidence of indebtedness constitutes gross income, the proper measure of the tax. Gross income on from trading securities is the amount received over and above their cost or purchase price.¹ Therefore, in response to the taxpayer's first question, the gains on the receivables are the amount realized from the receivables less their cost.²

This is also consistent with the application of the rule to gains and losses on the sales of mortgage securities in Det. No. 89-474, 8 WTD 259 (1989). That determination provides that Rule 162 enables financial institutions to net gains against losses from the sale of mortgage securities on a monthly basis. While the Rule only specifically refers to stockbrokers and security

¹ WAC 458-20-162 (Rule 162) provides in part:

GROSS INCOME FROM TRADING. Gross income from trading is the amount received from the sale of stocks, bonds and other securities over and above the cost or purchase price of such stocks, bonds and other securities.

² The cost of a receivable includes any amount paid for the receivable. However, it does not include any expenses regardless of whether they are related to a particular receivable or not.

houses, the Department through that determination included similar treatment for financial institutions. The same treatment should apply to the proposed subsidiary which will be factoring the receivables.

In response to the taxpayer's second question, the same treatment applies whether the receivable is collected from the obligor (debtor) on the receivable, or sold to a third party. The taxpayer is not in the business of vending the materials or providing the services underlying the receivables. It is merely factoring the receivables. Whether its gains are generated by collecting them or selling them to a third party is immaterial.

Rule 162 specifically provides that:

(2) Loss sustained upon any earnings account may not be deducted from or offset against gross income upon any other account, nor may a loss sustained upon any earnings account during any month be deducted from the gross income upon any account for any other month; (Emphasis supplied.)

This clearly answers the taxpayer's third and fourth questions. The gains may only be offset by losses in the month in which they are incurred. Net losses may not be carried over.

RCW 82.04.290 provides in part:

Upon every person engaging within this state in any business activity other than or in addition to those enumerated in RCW 82.04.230, 82.04.240, 82.04.250, 82.04.255, 82.04.260, 82.04.270, and 82.04.280; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.50 percent. This section includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." . . .

The taxpayer's factoring business is a service which is not enumerated in the cited sections and does not constitute a retail sale. Therefore, it is classified as "other business or service" activity with its gross income currently taxed at the rate of 1.50 percent.

DECISION AND DISPOSITION:

To summarize in response to the questions presented, factoring gains may be offset by factoring losses incurred in the same month. It does not matter whether they are sold to a third party or collected from the original debtor. The gross income is taxable under the other business or service business and occupation tax rate of 1.5 percent.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(9) and is based upon only the facts that were disclosed by the taxpayer. In this regard the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed were actually true. This legal opinion shall bind this taxpayer and the department upon those facts. However, it shall not be binding if there are relevant facts which are in existence but not disclosed at the time this opinion was issued; if false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 14th day of November 1991.