

Cite as Det. No. 89-459A, 11 WTD 17 (1991)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 01-006, 20 WTD 124 (2001).

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the)	FINAL
Determination of Tax)	DETERMINATION
Liability of)	
)	No. 89-459A
)	
...)	Registration No. ...
)	

Rule 194: B&O TAX--APPORTIONMENT--BANK--INTEREST COSTS--CLARIFICATION. Under the cost method of apportionment, interest costs incurred by a bank are apportioned, in the same manner as all other expenses, to the location where services associated with that expense were performed. Interest expenses are apportioned to the location that incurs the payroll and property expenses in managing the borrowing activities that give rise to the interest expense.

NATURE OF ACTION:

See 8 WTD 227 (1989). On its own motion, as set forth below, the Department amends, in part, and reverses in part, Section [3] of 8 WTD 227 concerning Allocation of Interest Expense.

FACTS AND ISSUES:

For a full description of the facts, see 8 WTD 227. The . . . , Seattle Branch, (hereinafter referred to as Bank or taxpayer) sought and received permission to report its B&O tax liability on a cost apportionment formula basis.

Herein we address a single issue previously discussed in 8 WTD 227: for purposes of apportioning a bank's income under the cost of doing business method of apportionment authorized by RCW 82.04.460 and WAC 458-20-194, what principle applies to determine whether interest expenses are a cost of doing business within Washington.

DISCUSSION:

The cost of doing business method of apportionment approved by the Department in 8 WTD 227 authorized the Bank to report its B&O tax liability by multiplying total income by the apportionment percentage obtained by "dividing the cost of doing business within this state by the cost of doing business both within and without this state." 8 WTD 227, at 237. Accordingly, the Bank's expenses must be characterized as either in-state expenses or out-of-state expenses. Id.

In the taxpayer's case, the funds for a significant portion of the Seattle branch's lending transactions are made available by other branches and offices of the Bank located outside the State of Washington. Substantial staff, labor and administrative resources are employed out of state in borrowing funds for lending transactions of the Seattle branch of the Bank, and staff of the Seattle Branch communicate their borrowing needs to out of state personnel and merely assist in a liaison role with those borrowing activities in an incidental and de minimis way.

In 8 WTD 227, the Department distinguished between the administrative costs incurred by the taxpayer in negotiating and managing a loan and the interest costs incurred in making a loan. Administrative expenses in negotiating and managing a loan were deemed to have fixed and definite situs. When negotiation and management services are performed out of state, such expenses shall be apportioned out of state. WTD at 238.

Interest expenses, however, do not have a clear situs. The Department in 8 WTD 227 stated that:

If it is meaningful at all to speak of interest on a loan as having a situs, then that situs must surely be where the loan proceeds are committed to use (in this case, to fund further lending transactions).

We conclude that when [Bank] borrows funds to finance loans by its Washington branch, then, for purposes of apportionment, the interest expense associated with acquiring those funds is a Washington cost of doing business irrespective of where the funds are borrowed.

WTD at 238.

Under this principle, interest expenses would be apportioned as an in-state or out-of-state expense depending on where loan funds were applied to the borrower's credit.

The Department has carefully reviewed and considered this issue, and on its own motion reverses 8 WTD 227 on this point.

We find no basis to apply different standards of apportionment for administrative expenses and interest expenses. Under a cost method of apportionment, all expenses, both general administrative and interest, can be fairly and accurately sourced to the location where services are performed and the costs associated with such services have been incurred. For apportionment purposes, interest expenses are to be allocated to the location where payroll and property costs are incurred in managing the borrowing activities that give rise to the interest expense.

The banking and financial business services and benefits which generate taxable gross receipts are essentially intangible. Most such services are today accomplished by sophisticated electronic technology which makes the sourcing of costs and services administratively difficult at best. Clearly, the application of special cost allocation and income apportionment methods is appropriate to fairly and uniformly calculate this state's share of taxable gross receipts. Thus, the Department is preparing a Washington Administrative Code rule to expressly govern apportionment by banks and financial institutions engaged in rendering financial services both within and outside this state, as contemplated under RCW 82.04.460(2). This rule will provide more precise apportionment methodology for uniform application on and after its effective adoption date.

DECISION AND DISPOSITION:

The original instructions in 8 WTD 227 to source interest expense to the location where the funds are committed to use are hereby reversed, ab initio.

DATED this 26th day of June, 1991