

Cite as Det. No. 92-195, 12 WTD 383 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Refund of	)	
	)	No. 92-195
	)	
. . .	)	Registration No. . . .
	)	
	)	

- [1] RCW 82.32.060 -- WAC 458-20-100: NONCLAIM PERIOD.  
When the taxpayer makes a timely request for a refund which the Department denied, the taxpayer must either file a petition in Superior Court or appeal that denial within the Department prior to the expiration of the nonclaim period. The Department may not extend the period for requesting a refund.
- [2] WAC 458-20-162: "ESTABLISHED SECURITY HOUSE" DEFINED.  
An established security house is a registered broker-dealer under the Washington Securities Act (Chapter 21.20 RCW) and/or The Securities and Exchange Act of 1934. Persons who are mere salespersons are not security houses.
- [3] WAC 458-20-111: ADVANCEMENTS AND REIMBURSEMENTS.  
Where the taxpayer has chosen to operate through independent contractor salespersons whose only contract is with the taxpayer, commissions received by the taxpayer from the issuers/sellers of the securities are not advances.

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: . . .

DATE OF HEARING: . . .

NATURE OF ACTION:

The taxpayer appeals the denial of its refund request for business and occupation taxes paid on commissions from the sale of securities which were paid to "independent contractors."

FACTS:

Coffman, A.L.J. -- [The taxpayer] was a member of the National Association of Securities Dealers, Inc. (NASD) and a registered broker-dealer with the Securities and Exchange Commission (SEC). The taxpayer was merged into [a corporation in August 1989]. [The corporation] filed the petition for refund on behalf of the taxpayer. The taxpayer is requesting a partial refund of business and occupation taxes paid during the period of October 1, 1985 through December 31, 1988 in the amount of \$ . . . . The original request for refund was submitted [in September 1990]. The Department's Taxpayer Account Administration Division denied the requested refund by letter dated [October 1990]. The taxpayer's appeal to the Interpretation and Appeals Division was postmarked [in September 1991].

The taxpayer's principal business was the sale of partnership interests and other securities including mutual funds, stocks, and bonds. These included both public and private offerings. To facilitate these transactions, sales, and offerings, the taxpayer entered into contracts with independent contractors (salespersons). These contracts contained the following provisions:

1. Salespersons were required to use their best efforts to sell any and all securities approved for sale by the taxpayer. ¶ 1.
2. Salespersons were required to comply with the procedures contained in the taxpayer's "Operations and Compliance Policy Manual." ¶¶ 2.1, 4.3, 4.4, and Exhibits A and D.
3. Salespersons were paid a commission based on the commissions received by the taxpayer. Payment of commissions was not made until after the taxpayer received the funds from the sellers/issuer. In the case of partnership interests, the taxpayer had the right to approve or reject the purchase order. ¶¶ 3.1 and 3.2.
4. Salespersons were required to be licensed as a securities salesperson with NASD or a principal with SEC. Preamble.
5. Salespersons could not hold customer's funds or securities. ¶ 4.7.

6. Paragraph 4.8 reads as follows:

The [salesperson] has no authority to act, and will not act, for any customer in any dealings in securities except as sales representative of [taxpayer] in the execution of orders given by [taxpayer's] customers and [salesperson] will not accept remuneration in any form from any person or business, directly or indirectly, on account of any dealings in securities without prior written approval of [taxpayer].

(Brackets added.)

7. Salespersons did not have the right to participate in any benefits offered to the taxpayer's employees and were responsible for all costs and expenses related to the contract.  
¶ 5.1

#### ISSUES:

This case raises two issues. Procedurally, is the requested refund timely? Substantively, this case is concerned solely with the receipt of commissions by the taxpayer and the deductibility of commissions paid to the independent contractor/salespersons.

The taxpayer contends that it is entitled to the requested refund for the following reasons:

1. The salespersons served the same function as "established security houses" and therefore it is unfair to treat payments to them differently solely because they are sole proprietorships.
2. The salespersons were not employees therefore the commissions paid to them are deductible under WAC 458-20-162.
3. The receipt of commissions from the issuers were actually advancements and reimbursements which are deductible under WAC 458-20-111.

#### DISCUSSION:

##### 1. Nonclaim Period.

[1] Generally, the taxpayer may request a refund of taxes paid no later than the last day of the fourth calendar year following payment. RCW 82.32.060. A taxpayer may make that request by applying for a refund with the Department (RCW 82.32.170) or

filing an appeal with the Thurston County Superior Court (RCW 82.32.180). The taxpayer's letter of [September 1990] was timely as to taxes paid in 1986 and thereafter. The Department's Taxpayer Account Administration Division denied the refund request [in October 1990]. In the event the Department denies a timely filed refund request, the taxpayer has till the later of the normal nonclaim period or 30 days following the denial to file an appeal in the Superior Court. RCW 82.32.180. Thus, the last day the taxpayer could have filed a petition with the Superior Court for taxes paid in 1986 was [in December 1990].<sup>1</sup> Further, WAC 458-20-100(2)(a) states:

A petition for review requesting a refund of taxes paid must be filed within four years after the close of the tax year in which the taxes were paid. Therefore, the department may not grant an extension of time to file a petition for review requesting a refund of taxes paid.

The Department may not act in direct contravention of statute. Such an act would be ultra vires. Duncan Crane v. Dept. of Rev., 44 Wn. App. 684 (1986). The filing of a petition with the Interpretation and Appeals Division [in September 1991] will not revive the taxpayer's refund rights for 1986. Therefore, the taxpayer's petition is denied as to taxes paid in 1986.<sup>2</sup>

## 2. Established Security House.

WAC 458-20-162 specifies the reporting requirements for stockbrokers and security houses. In particular it provides:

GROSS INCOME FROM COMMISSIONS. Gross income from commissions is the amount received as commissions upon transactions for the accounts of customers over and above the amount paid to other established security houses associated in such transactions: PROVIDED, HOWEVER, That no deduction or offset is allowed on account of salaries or commissions paid to salesmen or other employees.

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<sup>1</sup>Chapter 169, Laws of 1992 amended RCW 82.32.060 to extend the statute of limitations when there is an executed waiver. The amendment is effective for those taxpayer's who had an executed waiver in effect on July 1, 1992. The taxpayer had not executed a waiver therefore the amendment is of no benefit to the taxpayer in this case.

<sup>2</sup>This includes the taxes for the fourth quarter of 1985 through the third quarter of 1986. Taxes for the fourth quarter of 1986 were paid in 1987.

(Emphasis added.)

The taxpayer argues that its salespersons "served the same function" as an established security house, therefore, it should be entitled to a deduction for commissions paid to the salespersons. During the hearing in this matter the taxpayer's representative suggested that a security house is an independent business entity in the business of selling securities. We do not subscribe to that definition.

[2] Title 82 RCW does not provide a statutory definition for the term "established security house." Our research has not disclosed any definition of a "security house." Statutory terms not defined in the statute are given their ordinary meanings as set forth in a dictionary. City of Seattle v. Hill, 40 Wn. App. 159 (1985). This rule applies equally to regulations because the regulations have the same force and effect as law. RCW 82.32.300.

The term "security" is defined in RCW 21.20.005(12) and includes the instruments sold by the taxpayer and the salespersons.

The term "house" is defined in Webster's as "A commercial firm <a fashion house>". Black's Law Dictionary, 873 (4th rev. ed., 1968) states: "The name 'house' is also given to some collections of men other than legislative bodies, to some public institutions, and (colloquially) to mercantile firms or joint-stock companies." (Emphasis added.) When we read these terms together it is apparent that the term "security house" means more than a mere salesperson. It must be an entity that is engaged in the business of offering securities to the public. The Securities Act of Washington defines a "broker-dealer" as precisely this type of business. RCW 21.20.005(3) states:

"Broker-dealer" means any person engaged in the business of effecting transactions in securities for the account of others or for that person's account. "Broker-dealer" does not include (a) a salesperson, issuer, bank, savings institution, or trust company, .  
 . .

(Emphasis added.)

The remaining exemptions deal with persons who are outside the scope of this state's jurisdiction.

The term "established" is defined in Webster's II New Riverside University Dictionary (Webster's) as:

2. To set in a secure condition or position  
<established them in the wholesale market>
3. To cause to be recognized and accepted <an  
invention that established their reputation>

RCW 21.20.040 requires "broker-dealers" to be registered. Likewise the Securities and Exchange Act of 1934 defines brokers and dealers in a similar fashion and requires "broker-dealers" to be registered. We find that an entity is an "established security house" only if it is a registered broker-dealer under Washington or federal law.

The taxpayer argues that an "established security house" may be a sole proprietorship. We agree. See RCW 21.20.005(9). However, that does not assist the taxpayer in this case. The independent salespersons were not broker-dealers. Rather, they were only required to be "licensed as a securities salesperson."<sup>3</sup> The license or registration of a securities salesperson is valid only if that individual is associated with a broker-dealer. RCW 21.20.080.

The taxpayer also argues that the phrase in WAC 458-20-162:

PROVIDED, HOWEVER, That no deduction or offset is allowed on account of salaries or commissions paid to salesmen or other employees.

means that commissions paid to nonemployee salespersons are deductible. We disagree. It is a well established rule of construction that superfluous words are not used. Automobile Drivers and Demonstrators Union No. 882 v. Dept. of Retirement Sys., 92 Wn. 2d 415, cert. den. 444 U.S. 1040 (1980). This language was written to clarify that not all salespersons are employees. Otherwise, it would have been sufficient to say "employees".

Further, the phrase "salesmen or other employees" is part of a proviso. The proviso would only apply if the original statement applied. In this case the "independent contractor salespersons" would have to be "established security houses" before the additional limitation would apply. The reason for the proviso is that it may be possible for a salesperson or employee to qualify as an "established security house." In that case, due to the close relationship a security house has with its sales staff, the deduction would not be available.

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<sup>3</sup>The taxpayer's representative stated [in July 1992] that the salespersons were required to be brokers, however the contract required only that they were licensed salespersons.

The independent salespersons were not "established security houses", thus the taxpayer is not entitled to the deduction referred to above. Further, the independent salespersons are salespersons and the proviso precludes the deduction of commissions paid to them. The taxpayer's petition is denied on this issue.

### 3. Advancement and Reimbursements.

[3] The taxpayer argues that its receipts of commissions from the issuers and others were actually advances for payments to be made to the independent salespersons. WAC 458-20-111 reads in part:

The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.

The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.

The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.

The taxpayer is arguing that moneys received by it from the issuers or sellers are advances. The requirements of this rule are spelled out in Christensen v. Dept. of Rev., 97 Wn. 2d 764, 768 (1982) where the Court said:

[A] payment to a taxpayer from a client is excluded from gross income if (1) it is customary reimbursement for an advance made to procure a service for the client, (2) the taxpayer does not or cannot render the service, and (3) the taxpayer was not liable for the payment.

However, the taxpayer did not present evidence that would show that it is customary in the securities business for the client to advance funds to the security house for payment to the sales staff. Further, the independent salespersons did not have contracts with the issuers or other payors. Rather, their contracts were with the taxpayer. The issuers/sellers contracted with the taxpayer not the salespersons. Because the payors of

the commissions had no liability to the salespersons and the taxpayer did, we find that no advances were involved.

The taxpayer also argues that the reasoning of Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dept. of Rev., 103 Wn. 2d 184 (1984) applies to its situation.<sup>4</sup> In Walthew the Court found that the law firm's receipt of funds from its clients for the costs of court reporters, physicians, and process servers were reimbursements and not subject to the business and occupation tax. The taxpayer failed to note the Court's clarification at page 18:

Reimbursements to attorneys for costs of litigation cannot by rules of this court constitute compensation. Lawyers are bound by the Disciplinary Rules of the Code of Professional Responsibility. DR 5-103 prohibits a lawyer from financing the costs of litigation unless a client remains ultimately liable for those costs. Thus an attorney must because of this rule act solely as agent for the client when financing litigation. Attorneys are unique in this respect. The Department's concern that other professionals will necessarily gain an exemption by our holding is misplaced.

(Emphasis added.)

The taxpayer has not pointed to any similar restrictions on its activities or compensation. Thus, the taxpayer's reliance on Walthew is misplaced.

#### DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied.

DATED this 23rd day of July 1992.

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<sup>4</sup>The taxpayer did not name this case, rather it referred to the "law firm cases" which we take to mean Christensen, supra and Walthew.