

Cite as Det. No. 93-172, 13 WTD 180 (1993)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 01-006, 20 WTD 124 (1999)

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 Correction of Assessment of)	
)	Det. No. 93-172
)	
...)	Registration No. ...
)	.../Audit No. ...
)	

RULE 194: APPORTIONMENT -- COST METHOD -- SEPARATE BUSINESS ACTIVITY. Income from a separate business activity is apportioned using only the costs related to that business activity.

This headnote is provided as a convenience for the reader and is 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:

A cooperative selling and financing equipment in Washington petitions for apportionment instructions regarding the costs used to apportion the financing income.

FACTS AND ISSUES:

Pree, A.L.J. -- ... (hereinafter referred to as the taxpayer) is a cooperative headquartered [out-of-state]. Many of its member farmers sell their produce to ... a food processing corporation which does business in Washington. The taxpayer also finances sales of equipment with financing leases to [the food processor].

The taxpayer's records were examined for the period January 1, 1987 through December 31, 1990 . . .

[Previously, we] allowed the taxpayer to treat a portion of the income in question from the financing leases as interest income taxable under the service and other business classification of the business and occupation tax. The taxpayer acknowledges nexus with Washington regarding the income in question and agrees that some of the income should be apportioned to Washington.

In its petition, the taxpayer protested the assessment of service business and occupation tax on all of its financing income. Both the Audit Division and the taxpayer agree that some of the income should be apportioned. No separate accounting method is applicable. The taxpayer agrees that the cost method of apportionment is appropriate, but disagrees that the costs of its produce selling business should be included in the formula.

DISCUSSION:

Interest income is taxable under the service classification. WAC 458-20-109 (Rule 109). RCW 82.04.460 provides the basis for apportionment of service income:

(1) Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

WAC 458-20-194 (Rule 194) provides a specific method for apportioning income from leasing personal property:

Persons domiciled outside this state who (1) sell or lease personal property to buyers or lessees in this state, or . . . are doing business in this state, irrespective of the domicile of such persons and irrespective of whether or not such persons maintain a permanent place of business in this state.

. . .

Persons engaged in a business taxable under the service and other business activities classification and who maintain places of business both inside and outside this state which contribute to the performance of a service, shall apportion to this state that portion of gross income derived from services rendered by them in this state. Where it is not practical to determine such apportionment by separate accounting methods, the taxpayer shall apportion to this state that proportion of total income which the cost of doing business within this state bears to the total cost of doing business both within and without this state.

No separate accounting method is available to apportion the taxpayer's Washington income. Therefore, we must examine the taxpayer's costs. Several issues are raised regarding which costs to include and where they are incurred.

First, we find that the financing lease activity of the taxpayer constitutes a distinct business, separate and apart from the sales of produce Therefore, there is no relationship between the costs of that business and the income attributable to the financing leases. The due process clause requires that there be a relationship between the income attributable to Washington and the intrastate values of the enterprise. Department of Rev. v. J.C. Penney Co., 96 Wn.2d 38, 633 P.2d 870 (1981). Only the financing lease costs should be considered when determining what portion of the financing lease income is subject to tax here. There is no relationship between the financing lease income and its produce sales.

The taxpayer has indicated that the major cost of the financing lease business was interest. Under the cost method of apportionment, interest costs 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. Det. No. 89-459A, 11 WTD 17 (1991) - (. . .). The Department is preparing a Washington Administrative Code rule to expressly govern apportionment of 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.

We understand that some of the charges for preparing the leases were incurred by [the food processor]. [The food processor's] costs cannot be considered part of the taxpayer's own activities. Under WAC 458-20-203 (Rule 203) related entities are recognized as separate entities. However, charges from [the food processor] to the taxpayer relating to specific financing leases, will be considered costs incurred by the taxpayer at the location where the property is leased. If [the food processor] charges cannot be identified as incurred because of any particular lease, they will be attributed to the taxpayer's domicile Det. No. 89-448, 8 WTD 189 (1989).

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part. The file will be returned to the Audit Division to apportion the financing lease income. The taxpayer will also have an additional sixty days to contact the auditor and provide the evidence of where its costs were incurred regarding the financing lease activity.

DATED this 21st day of June 1993.