

Cite as Det. No. 94-031, 14 WTD 194 (1995)

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 Refund of)	
)	No. 94-031
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .

- [1] RULE 194; RCW 82.04.460, 82.04.4286: APPORTIONMENT -- OUT-OF-STATE SERVICES -- PLACE OF BUSINESS. Apportionment may not be denied solely because a taxpayer does not maintain a place of business outside this state if it performs substantial services outside Washington for out-of-state customers.
- [2] RULE 194; RCW 82.04.460: SERVICE B&O TAX -- APPORTION-MENT. If practical, taxpayer shall apportion income by separate accounting methods. Otherwise, taxpayer shall apportion income on the cost-of-doing business basis when it provides administrative services in Washington to out-of-state customers. Merely separating commission income by where the sale occurs does not constitute separate accounting.

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.

NATURE OF ACTION:

The taxpayer protests the Department of Revenue's (Department) failure to apportion an assessment of service business and occupation (B&O) tax on income earned as commissions from out-of-state sales.¹

¹Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

De Luca, A.L.J. -- The Department audited the taxpayer for the period January 1, 1988 through December 31, 1992 and assessed the taxpayer taxes, penalties and interest. The taxpayer has paid all but a portion of the assessment plus accrued interest. We will treat the taxpayer's May 4, 1992 letter as a refund petition because of his payments.

The taxpayer is an independent contractor who sells large industrial pumping equipment and control valves for manufacturers of such equipment. They pay him on a commission basis. The taxpayer's office is in his Washington home. However, the taxpayer's representative estimates that 75% of the taxpayer's work occurs outside of Washington with the remainder in Washington. The taxpayer explains that the manufacturers require him to perform in the field many of the activities necessary for the equipment sales. He states that he spends a great deal of his time visiting consulting engineering firms and trying to influence their choice of equipment for projects. During the visits he explains the products and how to use them.

If the party selects the equipment, the taxpayer states he must visit the site to advise the installation contractor; make final adjustments to the equipment; oversee the startup; and train the owner's personnel in operating and maintaining the equipment. For all equipment he sells, he conducts full-day training sessions to advise such personnel how to operate and maintain the pumps and valves. He holds these meetings at various places convenient to the customers' plants and factories. The taxpayer does not charge extra for these training sessions. They are included in the purchase price, from which he receives his commissions.

The taxpayer further explains while travelling and working in the field he carries portable files, a technical reference library, demonstration equipment, and a cellular telephone. He also carries small tools and testing equipment to make the final adjustments and "troubleshoot" new equipment after it is installed.

The audit report attributed all of the taxpayer's commission income to Washington and denied him apportionment for two reasons. First, the taxpayer does not maintain a place of business outside Washington. Second, the report considered the taxpayer's out-of-state activities as only "incidental to the total services performed in Washington."

ISSUE:

Is the taxpayer entitled to apportion his income from sales occurring outside Washington?

DISCUSSION:

WAC 458-20-194 (Rule 194) provides in part:

Persons domiciled in and having a place of business in this state, who (1) sell or lease personal property to buyers or lessees outside this state, or (2) perform construction or

installation contracts outside this state, or (3) render services to others outside this state, are doing business both inside and outside this state. Whether or not such persons are subject to business tax under the law depends upon the kind of business and the manner in which it is transacted.

The audit report relied upon the portion of Rule 194 which states:

When the business involves a transaction taxable under the classification service and other business activities, . . . the tax applies upon the income received for services incidentally rendered to persons outside this state by a person domiciled herein who does not maintain a place of business within the jurisdiction of the place of domicile of the person to whom the service is rendered.

The taxpayer disagrees with the audit report's reliance on this provision. The taxpayer contends his out-of-state services are not incidental. Det. No. 87-186, 3 WTD 195 (1987) addressed this same provision of Rule 194 by stating:

The key word is incidentally. Where, as here, services are substantially rendered to persons outside this state, the provision has no application.

[1] In effect, Det. No. 87-186 holds that a business must maintain an out-of-state office to qualify for apportionment only if the out-of-state activities are incidental. However, if the benefits derived by the customer are a direct result of out-of-state services performed by the business, those services are more than incidental. When this is the case, the business is entitled to apportion its service income even though it does not have an out-of-state office. Indeed, Det. No. 87-186 plainly states at 196 "apportionment may not be denied solely because the taxpayer does not maintain a place of business outside this state." See also Det. No. 90-163, 9 WTD 286-39 (1990). Det. No. 87-186 at 198 concluded by holding whether or not the taxpayer meets the precise terms of RCW 82.04.460 and Rule 194, "the U.S. Constitution, and thus RCW 82.04.4286 require apportionment of gross receipts derived from business activities which are substantially performed both within and without the state."

Det. No. 87-186 at 196 cites Dravo Corp. v. Tacoma, 80 Wn.2d 590 (1972) and holds that a taxpayer "is liable only to the extent that it engages in taxable business activities within this state." Where the taxpayer also engages in substantial activities without the state, the determination declares Washington "has no power to levy a tax upon activities that occur outside its territorial limits." Thus, "a Washington tax on gross income derived from activities substantially performed both within and outside this state would be a tax out of all proportion to the business transacted in this state, . . ." Det. No. 87-186 at 197 citing Chicago Bridge & Iron Co. v. Department of Rev., 98 Wn.2d 814 at 823 (1983).

In the present matter we believe the taxpayer's out-of-state activities, as described to us, are more than incidental. He is doing more than just showing his products or taking orders. His out-of-state customers directly benefit from his services when he visits their locations to advise the contractors

installing the equipment he sold and when he oversees the startup of that equipment. The customers also benefit when the taxpayer tests and makes final adjustments to the equipment to ensure desired performance. Furthermore, the customers benefit when the taxpayer trains their personnel in how to operate and maintain the equipment. The training sessions occur after the purchases and last a full day. He is entitled to apportion his income.²

We understand that the taxpayer has not filed tax returns with Oregon. However, Det. No. 87-186 at 198 holds:

. . . it is irrelevant whether any other state imposes a tax on any portion of the taxpayer's gross receipts. Washington may assert B&O tax only to the extent that the taxpayer engages in taxable business within the territorial limits of this state, Dravo Corp. v. Tacoma, *supra*. And gross receipts derived from services substantially rendered both within and outside this state are entitled to apportionment, regardless of whether any other state chooses to tax any portion of such receipts.

[2] Finally, Rule 194 describes methods regarding how to apportion income between states:

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.

See also RCW 82.04.460. If practical, the taxpayer shall apportion his income by separate accounting methods. Otherwise, the law requires the taxpayer to apportion his commission income by the cost-of-doing business basis. It appears the taxpayer may need to apportion his income by the cost of doing business method because he has in-state administrative expenses when rendering services to his out-of-state customers. See Det. No. 90-132, 9 WTD 280-15 (1990). For example, the taxpayer has his office in Washington where he conducts at least some of his business with his customers and the manufacturers he represents. He also has tools, files, reference materials, a truck etc. which he uses both in Washington and out-of-state. Moreover, the fact that a sale occurs outside Washington does not mean that all commission income from that sale is allocated to the place of sale when activities that significantly contribute to making the sale take place in Washington. Det. No. 90-163, *supra*.

²This determination was issued prior to the publication of Det. No. 93-276, 13 WTD 392 (1993). We believe Det. No. 93-276 misleads the reader somewhat by implying that in all instances the mere soliciting of sales outside Washington amounts to more than incidental services being performed. Instead, the facts in each case must be reviewed to determine whether sales or other types of out-of-state activities are incidental or not.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. We remand this matter to Audit Division in order to apportion the taxpayer's commission income earned from his out-of-state sales when he renders substantial services there.

DATED this 24th day of February 1994.