

Cite as Det. No. 15-0093, 36 WTD 080 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
))	No. 15-0093
))	
. . .)	Registration No. . . .
))	

[1] RULE 141; RCW 82.04.050: B&O TAX – RETAIL SALES TAX – EXEMPTION – PROXY VOTING SERVICES – MAILING BUREAU. A company engaged in “proxy voting services” is not engaged in “mailing bureau activities.”

[2] RULE 155; RCW 82.04.290; RCW 82.04.460: B&O TAX – SERVICE AND OTHER ACTIVITIES – APPORTIONMENT – PROXY VOTING SERVICES – INFORMATION SERVICES. For periods prior to July 26, 2009, a company engaged in “proxy voting services” are in the nature of “information services” and were properly taxed under the service and other activities B&O tax classification. Taxpayer is entitled to apportion its “proxy voting services” income if it earned apportionable income in Washington and another state.

[3] RCW 82.04.192: B&O TAX – RETAIL SALES TAX – PROXY VOTING SERVICES – TRANSFERRED ELECTRONICALLY – DIGITAL AUTOMATED SERVICE – DATA PROCESSING SERVICES. For periods on or after July 26, 2009, a company engaged in “proxy voting services” that are transferred electronically is providing digital automated services. Because those proxy voting services do more than “extract required information” or “convert data to usable information” the company is not engaged in “data processing services” that are exempt from retail-taxation. Taxpayer’s proxy-voting services are retail-taxable digital automated services.

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.

Weaver, A.L.J. – A company engaged in the business of providing proxy voting services to brokerage houses and banks petitions for correction of assessment of retail sales tax and retailing business and occupation (B&O) tax on the processing fees and intermediary fees it charges its customers. We hold that the company’s proxy voting services are taxable under the service and other activities B&O tax classification for periods prior to July 26, 2009. However, we hold that the company’s proxy voting services are taxable as digital automated services for periods after

July 26, 2009, and are therefore subject to the retail sales tax and retailing B&O tax for those periods. . . . Taxpayer’s petition is granted in part and denied in part.¹

ISSUES

1. Whether, under RCW 82.04.050(2)(a) and WAC 458-20-141, proxy voting services are taxable as “mailing bureau activities.”
2. Whether, prior to July 26, 2009, a company engaged in the business of providing proxy voting services is engaged in retail-taxable mailing bureau services under WAC 458-20-141 or service-taxable information services or data processing services under former WAC 458-20-155 and WAC 458-20-15501.
3. Whether, under RCW 82.04.192, a company engaged in the business of providing proxy voting services is providing retail-taxable digital automated services or data processing services.

. . .

FINDINGS OF FACT

[Taxpayer] is the former “Brokerage Services” of [Parent]. Taxpayer was first incorporated [out-of-state] as a wholly-owned subsidiary of Parent on March 29, 2007. On March 30, 2007, Taxpayer was spun off from Parent and began operating as an independent public company. Taxpayer’s services include investor communications, securities processing, and operations sourcing options.

Taxpayer’s customers include brokerage firms, global banks, mutual funds, annuity companies, institutional investors, specialty trading firms, and clearing firms. Taxpayer’s business operations are divided into two business segments: (1) investor communications solutions, and (2) securities processing solutions. Taxpayer provides its investor communications solutions to customers in Washington State.

A large percentage of Taxpayer’s “investor communication solutions” business involves the processing and distribution of proxy materials to investors in equity securities and mutual funds, as well as the facilitation of related vote processing. Through its proxy services, Taxpayer helps its clients (broker-dealers and banks) fulfill their regulatory responsibilities. Taxpayer manages and facilitates every aspect of the proxy voting process, including: proxy distribution, voting, tabulation, and reporting, institutional proxy voting, paper, telephone, Internet, and mobile voting services for shareholders, global proxy management, and notice and access.

In order to better serve its clients, Taxpayer has developed several proprietary automated tools. Such tools include the following:

- . . . – which allows stockholders to use any browser-enabled mobile or tablet device to cast proxy votes;
- . . . – which provides a preview of shareholder voting trends as they take place;

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

- . . . – which allows clients to facilitate shareholder meetings remotely by providing an online login for visual and audio access for each shareholder;
- . . . – which streamlines multiple delivery channels into a single-visit financial portal for regulatory delivery notices and day-to-day account and investment information; and
- . . . – which supports electronic, real-time voting.

Proxy communications are delivered both electronically and in paper form. However, Taxpayer has developed safe and convenient electronic tools like the tools listed above in an effort to reduce the delivery of proxy materials through the U.S. Mail and to encourage shareholders to use e-communications.

Ultimately, the decision as to whether materials are mailed or delivered electronically is made by individual shareholders. Under its client contracts, Taxpayer is required to honor shareholder delivery preferences. Taxpayer is also contractually required to maintain secure paths and systems that allow shareholders to vote through a variety of methods, including paper ballots, electronically through an Internet web-portal, electronically through an identified proxy vote agent, or by toll-free telephone.

Typically, publicly-traded shares are not registered in the name of the ultimate beneficial owner. Instead, substantially all public companies' shares are held in "street name," meaning that they are held on record by broker-dealers or banks through their depositories. The [Depository] holds shares on behalf of its participant broker-dealers and banks. Those broker-dealers and banks, known as "nominees" because they hold securities in name only, hold shares on behalf of their clients who are the actual individual beneficial owners. Nominees, upon request, are required to provide registrants (corporations or other issuers) with a list of beneficial owners. Taxpayer provides its clients beneficial owner request fulfillment services and is required, pursuant to its contract, to perform those services in accordance with Securities and Exchange Commission ("SEC") regulations.

When a corporation issues an "omnibus proxy," the [Depository] executes the proxy to transfer its voting rights to its participant nominees. Once an annual meeting date is set, nominees (which are Taxpayer's clients) have three days to transfer to Taxpayer, via powers of attorney, the authority to execute a proxy, which they receive from [Depository] via the omnibus proxy. Taxpayer then distributes, via mail or e-delivery, the proxy materials and voting instruction forms to shareholders.

Leading up to an annual meeting, Taxpayer periodically tabulates the proxy votes it has received and prepares a report showing the votes cast as they are received. Taxpayer uses this report to determine which shareholders have not voted and re-delivers the voter instruction forms to the non-participating shareholders. Once voting is complete, Taxpayer will tabulate the votes and create a multi-proxy report summarizing the results. In providing its proxy services, Taxpayer is required by contract to comply with SEC and New York Stock Exchange ("NYSE") rules and regulations. These rules govern how proxy voting materials must be transmitted, time limitations, and billing processes. Specifically, the NYSE rules require Taxpayer to include its proxy service fees in the "processing fee" line item of its invoices.

Taxpayer's invoices contain the following separately stated fees:

- Processing Fee
- Mail Elimination Fee
- Intermediary Fee
- Postage
- Envelopes/Forms
- Other

The Audit Division of the Department of Revenue ("Department") examined Taxpayer's books and records for the period of January 1, 2006, through June 30, 2011. During that period, Taxpayer reported all of its Washington revenue under the retailing business and occupation ("B&O") tax classification and then deducted all of its sales, claiming they were "non-taxable" under the retail sales tax classification as postage. The Audit Division determined that 71.6% of these deductions were for postage and materials and were properly excluded.

The remaining 28.4% of the deductions taken were for processing and intermediary fees. The Audit Division determined that Taxpayer's services were "mailing bureau" services, disallowed the deductions related to the processing and intermediary fees, and subjected those fees to retail sales tax. Because charges for direct delivery are also excluded from the measure of B&O tax, the Audit Division allowed a credit for B&O tax previously paid on postage charges.

On January 30, 2013, the Audit Division issued Assessment No. . . . for the period January 1, 2006, through December 31, 2009, totaling \$ This assessment included \$. . . in retail sales tax, a retailing B&O tax On January 30, 2013, the Audit Division also issued Assessment No. . . . , for the period January 1, 2010, through June 30, 2011. This assessment included \$. . . in retail sales tax, a retailing B&O tax credit of \$. . . , \$. . . in interest, and a 5% assessment penalty of \$

ANALYSIS

1. Taxpayer is Not Providing Mailing Bureau Services.

During the years in question in this appeal, Taxpayer was reporting all of its Washington revenue under the retailing B&O classification and then deducted the bulk of that revenue as "postage" costs. The Audit Division disallowed Taxpayer's "postage" deduction for the processing fees and intermediary fees Taxpayer charged, after determining that those fees were not being charged for the "delivery charges made for the delivery of direct mail" and were therefore not eligible for the retail sales tax exemption. *See* RCW 82.08.807; RCW 82.08.010(4) and (5).

On appeal, Taxpayer takes a new position, namely, that its services are not retail-taxable at all, and are, instead, service-taxable "information services." Therefore, the issue in this case involves the proper B&O tax classification of Taxpayer's income. The Audit Division contends that Taxpayer's processing fee and intermediary fee income is properly taxed under the retailing B&O tax classification, is not eligible for the "delivery charges made for the delivery of direct mail" retail sales tax exemption, and is therefore subject to retail sales tax.

RCW 82.04.050 provides that the term “sale at retail” includes “labor and services rendered in respect to . . . the . . . altering, imprinting or improving of tangible personal property of or for consumers.” RCW 82.04.050(2)(a). WAC 458-20-141 (“Rule 141”) defines mailing bureaus and mailing bureau activities as follows:

(3) **Mailing bureau services.** Mailing bureaus, also referred to as mail houses, prepare for distribution mail pieces such as bulletins, form letters, advertising material, political publications, and flyers as directed by their customers. The customer may provide the mail pieces to be prepared for distribution or the mailing bureau itself may sell the material to the customer . . .

(a) **Mailing bureau activities.** Activities conducted by mailing bureaus include, but are not limited to, picking up, addressing, labeling, binding, folding, enclosing, sealing, tabbing, and mailing the mail pieces. The mailing bureau generally charges the customer on a per-piece basis for each separate service provided plus the actual cost of any postage.

Charges for labor and services rendered in respect to altering, imprinting, or improving tangible personal property of or for consumers are retail sales Thus, the retailing B&O tax applies to income received from consumers for services that include addressing, labeling, binding, folding, enclosing, sealing, and/or tabbing. Mailing bureau businesses are also responsible for collecting and remitting retail sales tax when making sales to consumers, unless a specific exemption applies.

Rule 141(3). Taxpayer contends that it is not a mailing bureau, but is instead a proxy voting services provider, and the mailing services it provides are incidental to the actual nature of its activities. Taxpayer states that its processing fees and intermediary fees are charged for facilitating investor communications, most often in the proxy voting context, where Taxpayer identifies shareholders eligible to vote, disseminates the proxy voting materials, and then processes and tabulates those votes. For the reasons outlined below, we are convinced that the “processing fees” and “intermediary fees” at issue in this case are not being charged for “mailing bureau activities.”

While Taxpayer certainly does engage in direct mailing activities in order to fulfill its investor communications and proxy voting services, the “processing fees” and “intermediary fees” that Taxpayer charges its clients are not charged for mailing bureau services. Taxpayer is hired by its clients to organize and facilitate the proxy voting process within the bounds of SEC and NYSE rules and regulations. Contractually, Taxpayer acts as its clients’ designated agent in performing its clients’ regulatory obligations. In order to fulfill those obligations, Taxpayer is required to mail proxy materials and voter information forms to eligible shareholders. But Taxpayer is not being hired for its expertise in mailing those forms. Taxpayer is being hired to navigate the databases of the [Depository] and its broker-dealer and bank clients to determine which specific individuals own shares on an eligible voting date and then facilitates the proxy voting for those eligible shareholders. The “processing fees” and “intermediary fees” that Taxpayer charges its client are not related to its direct mailing function, but, instead, are charged for the proxy vote facilitation services Taxpayer provides to its clients.

The fact that Taxpayer provides for and charges its clients for the mailing costs that result from the dissemination of the proxy voting materials is incidental to Taxpayer’s actual business

function. Given the totality of the services Taxpayer provides its clients, it is incorrect to characterize Taxpayer as a mailing bureau because it engages in the act of mailing proxy voting materials to eligible shareholders. While we are convinced that the activities giving rise to the processing fees and intermediary fees are not mailing bureau activities, that decision does not end our inquiry into the question whether Taxpayer's proxy voting services are retail-taxable or service-taxable.

2. Taxability of Taxpayer's Proxy Voting Services Prior to July 26, 2009.

Taxpayer contends that its processing fees and intermediary fees are subject to the service classification because the services giving rise to those fees are properly characterized as "information services." Between January 1, 2006, and July 25, 2009, WAC 458-20-155² ("Rule 155") defined "information services" as follows:

The term "information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs.

Rule 155. Rule 155 then distinguishes between sales and [information] services in the following manner:

If information services, computer services or data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges

Id. Persons who charge for providing information services are subject to the service and other activities classification of B&O tax. *Id.*

In Determination No. 05-0325, 27 WTD 99 (2008), the Department determined that taxpayers providing electronic insurance claim-processing services were engaged primarily in providing information services. 27 WTD 99, 107. The determination focused on the fact that the taxpayers provided pharmacies and hospitals access to insurance information and submitted insurance claims for their customers. *Id.* The taxpayers, in that case, accessed and used insurance data to deliver insurance information and submit claims. *Id.* The determination concluded that the taxpayers, in 27 WTD 99, were engaged in information services, and their use of network telephone services were incidental to fulfilling their insurance processing function. *Id.* Similarly, in this case, Taxpayer provides its clients more than just the medium by which information is transferred.

² On January 16, 2009, the Department promulgated WAC 458-20-15501, which contained the same definition of information services. *See* WAC 458-20-15501(401)(a)(i). Rule 155 was repealed and WAC 458-20-15501 was amended, effective March 28, 2013, with the adoption of the Department's new digital goods regulations. *See* WAC 458-20-15501, -15502, -15503. On March 28, 2013, the [prior Rule 15501] definition of "information services" was eliminated from those digital goods regulations. *See id.*

Taxpayer collects, processes, and manipulates data into new forms of information, such as voter information forms and proxy voting reports, and then transmits that information to shareholders and its clients. Taxpayer is able to send proxy votes to eligible shareholders and then tabulate the votes.

Rule 155 provided that when the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services. *See* Rule 155. In this case, the proxy voting material that Taxpayer creates and mails to the eligible shareholders is simply the medium on which the shareholder information is carried so that Taxpayer can carry out its duties of facilitating and tabulating the results of a proxy vote for its clients. Taxpayer's service is in the nature of a professional service and, prior to July 26, 2009, such services are not subject to the retail sales tax. *See* Rule 155. Accordingly, we conclude that, prior to July 26, 2009, Taxpayer's processing fees and intermediary fees were for its proxy voting services and those services were in the nature of "information services."

In any event, the income derived from those services is subject to Washington taxation under the service and other activities B&O tax classification, for periods prior to July 26, 2009. The proxy voting services were not retail-taxable mailing bureau activities. Because Taxpayer's proxy voting services were not retail-taxable mailing bureau activities and were not otherwise "an activity taxed explicitly under another section in this chapter," Taxpayer's proxy voting services were properly taxed under the catch-all "service and other activities" B&O tax classification prior to July 26, 2009. *See* RCW 82.04.290. To the extent Taxpayer earned apportionable income in another state on its proxy voting services prior to July 26, 2009, Taxpayer is entitled to apportion its income subject to tax under the service and other activities B&O classification if it earned apportionable income in Washington and another state. *See* RCW 82.04.460.

3. Taxability of Taxpayer's Proxy Voting Services [on or] after July 26, 2009.

Digital products legislation, effective July 26, 2009, introduced the concept of the digital automated service and addresses how that service is taxed. Washington imposes retail sales tax on retail sales in this state. RCW 82.08.020. The term "retail sale" includes (among other things) sales to consumers of digital automated services. RCW 82.04.050(6)(b)(i), (8)(a). A "digital automated service" means "any service transferred electronically that uses one or more software applications." RCW 82.04.192(3)(a). It is not necessary that a copy of the product be physically transferred to the purchaser. RCW 82.04.192(8). So long as the purchaser may access the product, it will be considered to have been electronically transferred³ to the purchaser." RCW 82.04.192(8). Taxpayer's proxy voting services include software applications that are provided electronically through an Internet web-portal and electronically through an identified proxy vote agent. We find that when Taxpayer's proxy voting services are transferred electronically, they meet the RCW 82.04.192(3) definition of a digital automated service.

³ WAC 458-20-15503 (Rule 15503) was promulgated after the periods at issue in this appeal, and it clarifies the meaning of "transferred electronically" as follows:

Generally, this means the product is transferred using the public internet, a private network, or some combination. However, it is not necessary that the product be delivered to the purchaser. As long as the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser. . . .

Rule 15503(102). Our holding in this case is in accord with the definitions in Rule 15503.

Having held that Taxpayer provides digital automated services, then, for periods [on or] after July 26, 2009, the issue in this case is whether Taxpayer's proxy voting services are exempt from retail sales tax as a "data processing service." On July 1, 2010, RCW 82.04.192 was amended to include a definition of "data processing services" that are not considered a retail "digital automated service."⁴ See RCW 82.04.192(3)(b). That definition reads as follows:

(xv) Data processing services. For purposes of this subsection (3)(b)(xv), "data processing service" means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to extract the required information in an appropriate form or to convert the data to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. . . .

RCW 82.04.192(3)(b)(xv).

Taxpayer's proxy voting services include software applications that are provided electronically. A large percentage of Taxpayer's proxy voting services involve the electronic processing and distribution of proxy materials, as well as the electronic facilitation of related vote processing. Taxpayer manages and facilitates every aspect of the proxy voting service process, including: proxy distribution, voting, tabulation, and reporting. Many of these services are distributed over the Internet, and through electronic mobile voting services.

Taxpayer has developed proprietary software to facilitate its proxy voting services. These proprietary tools allow stockholders to use browser-enabled mobile or tablet devices to cast proxy votes. They also provide Taxpayer's customers with live-time previews of stockholder voting trends. In addition, Taxpayer's clients can hold stockholder meetings remotely by providing online logins for visual and audio access for stockholders.

Taxpayer periodically tabulates proxy votes electronically and prepares electronic reports for its clients. Taxpayer then uses these reports to determine which stockholders have not voted and then re-delivers voter instruction forms to the non-participating stockholders electronically. Taxpayer is hired by its clients to organize and facilitate the proxy voting process within the bounds of SEC and NYSE rules and regulations, and acts as its clients' designated agent in performing its clients' regulatory obligations. In fulfilling these duties, Taxpayer navigates the databases of the [Depository] and its broker-dealer and bank clients to determine which specific individuals own shares on an eligible voting date and then facilitates the proxy voting for those eligible shareholders.

We find that Taxpayer's electronic proxy voting services do more than "extract required information" or "convert data to usable information." Taxpayer's electronic proxy voting services are a comprehensive investor communications system that manages and facilitates every aspect of the proxy voting process, including: proxy distribution, voting, tabulation, and reporting, institutional proxy voting, Internet and mobile voting services for shareholders, global proxy management, access to third party databases, notice to stockholders, and compliance with

⁴ This amendment was retroactive to July 26, 2009, the date of the original digital products legislation.

regulatory requirements. Because Taxpayer’s electronic proxy voting services are significantly more complex than simply “extracting required information” or “converting data to usable information,” we hold that its digital automated services do not qualify as a “data processing services” under RCW 82.04.192(3)(b)(xv). As such, we find that Taxpayer’s electronic proxy voting services are retail-taxable digital automated services.⁵

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DECISION AND DISPOSITION

Taxpayer’s petition is granted in part, and denied in part.

Dated this 10th day of April, 2015.

⁵ To the extent that Taxpayer provides non-electronic proxy voting services to customers who elect (or are required) to undertake their proxy voting through the U.S. mail, those non-electronic services cannot be considered digital automated services, as they are not “transferred electronically.” *See* RCW 82.04.192(3). Revenues generated through non-electronic services are subject to the service and other activities B&O tax, because we have held that Taxpayer is not a mailing bureau and is not engaged in mailing bureau activities. *See* Part 2, *supra*; *see also* RCW 82.04.290.