Cite as 5 WTD 83 (1988)

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

In the Matter of the Petition For Correction of Assessment And Ruling of Tax Liability of . . .	D E T E R M I N A T I O N No 88-33 Registration No. . . . Tax Warrant No. . . .

[1] **RULE 211:** RETAIL SALES TAX -- B&O TAX -- PURCHASE OF A LESSOR'S RIGHT, TITLE, AND INTEREST IN ENCUMBERED LEASE PAYMENTS -- TAX LIABILITY OF PURCHASER. A surety insurer which acquired a lessor's right, title and interest in lease payments in order to protect its interest by servicing the leases is liable for collecting and remitting the retail sales tax on the rentals, and is liable for Retailing B&O on the gross income from the rentals when the payments fall due. The fact that the previous lessor received the beneficial interest from the lease payments and the payments were fully encumbered is not controlling.

[2] **RULE 228:** RCW 82.32.105 -- PENALTY -- SITUATION 7 -- LACK OF KNOWLEDGE -- UNINTENTIONAL CIRCUMSTANCE. Lack of knowledge of a tax obligation resulting in failure to file returns and pay taxes is not a circumstance beyond the control of a taxpayer. All sub-parts of situation 7 in Rule 228 must be met in order for a penalty to be waived. Accord: 3 WTD 237 (1987).

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 requests a waiver of delinquent penalties and a ruling that it is not doing business in this state in its own capacity.

FACTS AND ISSUES:

Frankel, A.L.J. -- . . . , dba [Corp A] Service Company (hereinafter referred to as the taxpayer) requests a written opinion and ruling of its tax liability under WAC 458-20-100(18). The taxpayer has paid B&O tax under protest, contending that it is only an agent for . . . (hereinafter [Corp A]) for collecting the lease payments at issue.

The taxpayer set forth the following background facts:

> On April 27, 1984 [the taxpayer] and [[Corp A]] entered into an agreement referred to as the Surety Commitment & Option Agreement. Under that agreement, [the taxpayer] agreed to provide surety insurance to [Corp A]'s lender . . . Bank of Washington, and certain investors.
>
> [Corp A], an . . . corporation formed in 1983, was in the business of buying commercial equipment leases from brokers located throughout the United States. [Corp A] financed the lease acquisitions through loans from [the bank] in the form of a revolving line of credit. [Corp A] granted to [the bank] a security interest in all lease payments from leases it acquired in order to secure the loan from [the bank].
>
> After a sufficient number of leases had been acquired by [Corp A] (usually an aggregate amount of approximately $5 million in leases) the leases were "pooled" and the stream of lease payments were assigned to institutional investors in private placement transactions. [Corp A] issued 60-month Leasebacked Promissory Notes to the investors for each private placement. The lease payment streams have been used to pay the investors under the Promissory Notes.

> Pursuant to the agreement between [the taxpayer] and [Corp A], [the taxpayer] issued three consecutive policies of surety insurance to [the bank] to guarantee payment on defaulted leases before the leases were pooled and sold to investors. [The taxpayer] further issued nine surety insurance policies to the trustees appointed to receive payment on the Leasebacked Promissory Notes issued by [Corp A] to the institutional investors.

In 1985, the taxpayer gave written notice to [Corp A] that it intended to terminate the Surety Commitment and option agreement and to discontinue providing new policies of insurance. The taxpayer stated [Corp A] threatened to discontinue to service the existing lease portfolio if the taxpayer did not arrange for or provide additional insurance.

On April 9, 1986, the taxpayer and [Corp A] executed a Purchase and Extension agreement. The taxpayer stated this was done because of the increased risk which would result if [Corp A] did not properly service the lease portfolio. Under the agreement, the taxpayer agreed to assume control of the servicing functions that had been performed by [Corp A].

On October 23, 1986, the state issued a tax warrant against [Corp A] for taxes due from March through August of 1986. (. . .)

Shortly after the warrant was issued, the Department received a letter from the taxpayer. (Letter of October 28, 1986.) The letter stated:

> With the filing of the enclosed returns, all sales/use tax collected through September 30, 1986, has been reported and forwarded to you.
>
> On April 1, 1986, we assumed the lease servicing support for [[Corp A]]. We did not assume any of their tax liability nor can we answer any questions regarding their tax liability prior to that date.
>
> To maintain proper cash accounting controls, lease payments are collected at a bank depository lock box. When [Corp A] Service Company acquired the servicing of the lease portfolio, [[Corp A]] did not have all of the necessary accounting procedures in place to allow us to segregate sales/use taxes by

> taxing authority and lock box. In order for the trustees to release that portion of the lease payment representing sales/use tax, special programming from our data processing department was required. The programming has now been completed and has been approved and accepted by the trustees. The tax funds are to be transferred by the 15th of each month and can, therefore, be submitted to you on a timely basis as required by your taxing agency.
>
> Since the trustees do not have funds available for the payment of interest and penalties, (they collect only the tax), we are directing the tax payment enclosed to be applied directly to the tax owing and not to interest or penalties. Furthermore, we respectfully request that interest and penalties be abated from April 1, 1986, forward, as negligence was not intended and the funds were not made available by the trustees for distribution.
>
> Very truly yours,
>
> [Corp A]
> by [Corp A] Service Company
> Its Authorized Agent

On December 23, 1986, [Corp A] sent copies of the Purchase and Extension agreement and Bill of Sale which it and the taxpayer had executed. (. . . .) The letter stated,

> Please note that as of April 1, 1986, [[Corp A]] is no longer collecting rents, sales taxes, property taxes and so forth from any lessee under any lease and therefore is no longer responsible for collection and remittance of these taxes. This obligation was assumed by [the taxpayer].

On the same date, the attorney for [Corp A] sent a letter stating that the warrant filed against [Corp A] was in error and should be cancelled. The letter stated that effective April 1, 1986 [Corp A] sold "all of its right, title and interest" in certain equipment leases to [the taxpayer]. That letter added:

> It appears that [the taxpayer] may be doing business as "[Corp A] Service Company" or a similar name and has been reporting its Washington state excise taxes under Registration No. . . . which is actually the

> registration number for [[Corp A]]. Apparently when [the taxpayer] assumed the equipment leases it just continued to use the prior lessor's [[Corp A]] registration number.
>
> Of course, if there is any Washington state tax liability attributable to [Corp A] for the period prior to April 1, 1986 which you stated may be in the amount of $. . . for March of 1986, [Corp A] will address that matter.

The Department then wrote the taxpayer stating that "per instructions" from [Corp A], the [Corp A] account was closed effective April 1, 1986. The letter requested payment of $ . . . balance due for taxes and penalty assessed for April through August of 1986.

An application for Certification of Registration was enclosed. The letter stated:

> "Failure to submit the balance due, the $15.00 registration fee and the application will necessitate a tax warrant being issued and distraint action taken against you as provided by law." (Letter of December 29, 1986.)

In response, the taxpayer sent a letter which contended it was only acting as an agent for [Corp A] and that it need not register with this state. The letter stated:

> [Corp A] Service Company is an unincorporated organization operated by [the taxpayer] solely for the purpose of administering an existing lease portfolio created by [[Corp A]] of . . . , which retains in most instances, the residual value of the leases and title to many items of equipment covered by the various leases. [Corp A] Service Company merely performs the billing and collection functions which were the responsibility of [[Corp A]] until it abandoned its responsibilities. [The taxpayer], as the insurer of the lease streams in favor of the various noteholders, took over that function solely to mitigate any potential damages to the noteholders and itself.
>
> Accordingly, it is the position of [the taxpayer] that it acts merely as an agent for [[Corp A]] and need not independently register with your state.

> [The taxpayer] intends to continue to remit tax payments that it receives from the lessees to you on behalf of [[Corp A]] under the existing tax account. (Letter of January 6, 1987 from senior bond counsel for the taxpayer.)

The Department opened an account for the taxpayer and issued a tax warrant (. . .) to cover unpaid taxes and delinquent penalties owing after April 1, 1986. The warrant was issued March 3, 1987. The taxpayer continued to file and pay the retail sales taxes under [Corp A]'s registration number. Above the signature line on the return the taxpayer stamped: "[Corp A] BY [Corp A] SERVICE COMPANY ITS AUTHORIZED AGENT."

The taxpayer argues that it is only performing the servicing function as agent for [Corp A] and that [Corp A] remains liable for the B&O tax. The taxpayer contends the lease payments which are made to [the bank] do not constitute either "gross proceeds of sales" under RCW 82.04.070 or "gross income of the business" under RCW 82.04.080. (Letter of May 4, 1987.)

In the alternative, the taxpayer contends that it has no B&O tax liability for Investment Tax Credit (ITC) retained leases owned by an [Corp A] subsidiary. The purchase agreement provided that neither the ITC-retained leases nor any interest therein was to be assigned or sold to the taxpayer. The taxpayer was only to have those rights or remedies with respect to those leases that it had pursuant to any insurance policies or other agreements. (. . . .)

The taxpayer also requests a waiver of the delinquent and warrant penalties pursuant to WAC 458-20-228(7)(c). The taxpayer stated that it was confronted with numerous accounting and data processing problems which were "inherited" from [Corp A]. One of the problems was the task of determining the status of tax liabilities in city, county and state taxing jurisdictions throughout the United States. The taxpayer described that task as "formidable." The taxpayer stated that its accounting personnel were unfamiliar with Washington's B&O tax and that [Corp A]'s failure to explain the nature of the B&O tax only exasperated the problem.

The taxpayer explained the basis of the request for the waiver of penalties was "that under these extraordinary circumstances, which were unforeseen and unintentional, the taxpayer was unable to fairly and reasonably determine its liability to the Department of Revenue because its accounting

personnel failed to properly account for payment of the tax." The taxpayer stated it has always acted in good faith with the Department in an effort to pay its tax liabilities, even when disputed or protested. (Letter of May 26, 1987 from taxpayer's attorney.)

DISCUSSION:

[1] B&O tax liability - In the letter requesting a ruling on its B&O tax liability, the taxpayer stated that it is now performing the "servicing function" which has always been [Corp A]'s responsibility. It described the servicing function as "monitoring lease payments and making sure lessees make their payments on a timely basis." In the Purchase and Extension Agreement, [Corp A] expressly warranted that it was unable to continue its servicing obligation and the taxpayer agreed to assume control of the servicing functions performed by [Corp A].

We do not find the purchase agreement creates an agency-relationship as the taxpayer contends. With the exception of the ITC-retained leases, the agreement provided that the taxpayer receive:

> 6. All interest in and rights of [Corp A] in and to all leases insured by [the taxpayer] (other than ones taken out on an uninsured basis on or before June 30, 1986) accruing after April 1, 1986 and to all equipment leased pursuant thereto, whether such leases are defaulted or not, and all bills of sale, invoices, assignments or similar instruments evidencing the owner's title to the equipment or leases, subject in each case only to:
>
> (a) The obligation on the part of [the taxpayer] to return any security deposits to the Lessees thereunder if and when due;
>
> (b) The obligations of [Corp A] under the trust indentures and trust agreements, line of credit agreements, servicing agreements and lock box agreements relating to the pools of leases insured by [the taxpayer] insurance policies (the "Trust Obligations");
>
> (c) The liens and rights of the purchasers of such leases (or the lease payment streams thereunder) and of the holders of any security interests therein,

> and the right of [Corp A]'s lenders to any funds in the trusts for insured leases (including any earnings on trust funds) remaining after all required payments to lease purchasers (or lenders) have been paid and after all trustee's fees, line of credit fees and interest on the lines of credit have been paid (other than late charges collected after April 1, 1986, which shall be for the account of [the taxpayer];

The taxpayer stated that [Corp A] had already received the beneficial interest in these lease payments and that the payments are only used to pay off [Corp A]'s promissory notes. It contends that it only assumed the status of "lessor" to allow it to adequately service the lease portfolios and that it did not assume [Corp A]'s tax liability.

[Corp A] does not agree that the taxpayer is performing the servicing function as its agent and neither the purchase agreement nor the Bill of Sale contains language that creates an agency arrangement. (. . . .)

If the agreement had provided that the taxpayer was only assuming the lessor's rights in order to service the leases and that the taxpayer would perform the lease servicing as agent of [Corp A], we would agree that [Corp A] would have remained liable for the B&O taxes owing. The agreement, however, was a purchase agreement and the taxpayer acquired the lease service facility and assets associated therewith. The assets included, in addition to the interest in the leases described above, the right to employ [Corp A]'s eleven servicing personnel, subleases and/or rights to lease the servicing facility and computer systems.

Washington's Revenue Act imposes taxes upon every person for the act or privilege of engaging in business activities. RCW 82.04.220. The Act defines business activities broadly as "all activities engaged in with the object of gain, benefit or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. The business and occupation tax is a tax on the gross revenues received in the course of business; whether a profit is realized on the transactions is immaterial. Budget Rent-A-Car v. Department of Revenue, 81 Wn.2d 171, 173 (1972).

The taxpayer agreed to perform the servicing functions because of the increased risk to itself if [Corp A] did not properly service the lease portfolio. This was done with the object of

benefit or advantage to itself and falls within the definition of a taxable business activity. Persons who rent or lease tangible personal property to users or consumers in this state are required to collect from their lessees the retail sales tax measured by the gross income from rentals as of the time the rental payments fall due. The renting or leasing of tangible personal property constitutes a "sale." RCW 82.04.040. The lessor is taxable under the retailing classification upon the gross income from the rentals when the rental payments fall due. WAC 458-20-211.[1]

We find the taxpayer is liable for collecting and remitting the retail sales tax on all lease payments under its control which are made by lessees located in this state. It is liable for the B&O tax on the gross income from the rentals of those leases for which it received all of [Corp A]'s right, title and interest.[2] If [Corp A] continues to hold some leases in its name to allow it to qualify for the investment tax credit, we would agree that [Corp A] is liable for the B&O tax on the income from those leases. An assessment should be issued against [Corp A] for any B&O taxes owing on leases for which it did not transfer its right, title and interest to the taxpayer. As the revenue officer noted, however, if the income from the ITC-retained leases is paid into the lockbox account that is controlled by the taxpayer, and [Corp A] fails to pay the tax, then the Department would be forced to levy the leases (accounts receivable) for the amount of tax and costs due.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the

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[1]The taxpayer has been reporting some Service B&O as well as Retailing B&O. Neither the taxpayer's petition or the information provided by the revenue officer states what income is being reported as subject to the Service B&O tax. If the taxpayer is receiving late payment charges or other fees for servicing the accounts, such amounts are subject to Service B&O. See WAC 458-20-224.

[2]The Bill of Sale (. . .) states that the taxpayer received all of [Corp A]'s right, title and interest in equipment leases listed on a computer printout attached to the Bill of Sale and all leases thereafter acquired or originated by [Corp A] and insured by the taxpayer.

taxpayer. In this regard, the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind this taxpayer and the department upon these facts. However, it shall not be binding if there are relevant facts which are in existence but have not been disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

[2] Penalties - The Purchase Agreement, inter alia gave the taxpayer full access to [Corp A]'s books and records, the right to employ [Corp A]'s servicing personnel, and the taxpayer assumed [Corp A]'s software license agreement and equipment lease. If [Corp A] had been collecting and remitting retail sales tax and retailing B&O in the lease payments at issue and this information was available to the taxpayer, it is unclear why the taxpayer was not aware of its obligation to remit the retail sales tax.

Even if the taxpayer was not aware of its tax collection obligations and was unfamiliar with a lessor's obligation to pay Washington B&O tax, lack of knowledge is not identified by statute or rule as a basis for abating late payment penalties. The late payment penalty does not hinge on deliberate or willful delinquency. Late payment penalties have been mandated since 1965 when the legislature specifically amended the law to limit the Department's discretion to waive penalties.

RCW 82.32.100 provides that if a taxpayer fails to make any return as required, the Department shall proceed to obtain facts and information on which to base its estimate of the tax. As soon as the Department procures the facts and information upon which to base the assessment, "it shall proceed to determine and assess against such person the tax and penalties due, . . . To the assessment the department shall add, the penalties provided in RCW 82.32.090." RCW 82.32.100. (Emphasis added.)

RCW 82.32.090 provides that if any tax due is not received by the Department of Revenue by the due date, there shall be assessed a penalty. A 20 percent penalty is mandated for

returns which are not received within 60 days after the due date.

Penalty provisions for the late payment of taxes are common. See, e.g., I.R.C. + 6651. Imposition of the late penalty is viewed as a means to partially compensate the state for the additional expense in collecting taxes that are late or not paid rather than solely as a punitive measure. The state does recognize the difference between nonpayment due to lack of knowledge of a tax obligation and tax evasion. In the case of intentional tax evasion, the Department is required to impose a penalty of 50 percent of the additional tax found due. RCW 82.32.050. No evasion penalty is assessed unless misrepresentation or fraud is specifically found. No such intent was found in the present case.

The only authority to cancel penalties or interest is found in RCW 82.32.105. That statute allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. The statute also requires the Department to prescribe rules for the waiver or cancellation of interest and penalties.

The administrative rule which implements the above law is found in WAC 458-20-228. Rule 228 lists the situations which are clearly stated as the only circumstances under which a cancellation of penalties and/or interest will be considered by the Department. In this case, the taxpayer relies on situation (7)(c). Situation 7 is in the conjunctive, however. The requirements of all four of the sub-parts must be met. 3 WTD 237 (1987) . . . .

In this case the return was not received by the department with full payment within 30 days after the due date. As subpart (a) was not met, situation 7 is not applicable.

The state does try to provide accessible taxpayer information. There are 17 regional offices around the state to assist taxpayers. The state also maintains an office of taxpayer information.[3] The ultimate responsibility for properly reporting and paying taxes, however, rests on persons in business. The state is not required to make sure a business

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[3]The toll-free number from states other than Washington is 1-800-233-6349.

knows its tax obligation before it can assess taxes, interest, or penalties.

DECISION AND DISPOSITION:

The taxpayer's petition for the waiver of penalties is denied.

DATED this 19th day of February 1988.