

Cite as Det. No. 89-253, 7 WTD 333 (1989)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 93-269ER, 14 WTD 153 (1995).

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)	
)	No. 89-253
)	
...)	Registration No. ...
)	.../Audit No. ...
)	
)	
)	

- [1] RULE 219: & RCW 82.04.4281 -- B&O TAXES -- SERVICE TAX -- PATRONAGE DIVIDENDS -- FINANCIAL BUSINESS. Patronage dividends received from a co-operative buying association are deemed to be income derived from investments. Where the taxpayer's activity that generated the dividends did not constitute a financial business, the taxpayer was entitled to a statutory deduction from B&O taxes under RCW 82.04.4281.

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 TELEPHONE CONFERENCE: April 19, 1989.

NATURE OF ACTION:

Taxpayer protests the assessment of tax under the Service and Other Activities tax classification on unreported patronage dividends.

FACTS AND ISSUES:

Okimoto, A.L.J. -- . . . , (taxpayer) operates a hardware store in . . . , Washington. The taxpayer's books and records were examined by the Department of Revenue (Department) for the period January 1, 1985 through September 30, 1988. The audit examination resulted in additional taxes and interest owing of \$ The taxpayer has paid the untested portion of the audit report, and the balance remains due.

The taxpayer stated at the telephone conference that when it first became affiliated with . . . , it was required to purchase ten shares of stock and become a stockholder. Each year after that it received patronage dividends from the corporation in the form of either cash or additional stock.

Because the taxpayer is a stockholder, it is entitled to purchase its merchandise from the co-operative corporation throughout the year. At the year end, the . . . computes its profits and losses and distributes a percentage of the profits to its stockholders based on the amount of merchandise they have purchased during the year.

In the audit, the auditor asserted Service B&O tax on unreported patronage dividends received by the taxpayer from its supplier, . . . and cited WAC 458-20-108 as its authority.

The taxpayer asserted at the telephone conference, that WAC 458-20-108, does not apply to the taxpayer since it is not the one issuing the patronage dividends, but only the recipient. The taxpayer also stated that it reports 100 percent of the sales price of merchandise purchased from . . . at the time it is sold to a customer. The taxpayer further states that it has never deducted patronage dividends from sales.

The taxpayer also argues that the Service and Other Activities tax classification does not apply to this type of income.

The sole issue to be decided is:

- 1) Are patronage dividends received by shareholders at the year end subject to Service B&O taxes?

DISCUSSION:

[1] We agree with the taxpayer in that we find both WAC 458-20-108 and WAC 458-20-219 to be inapplicable to the taxpayer's case. Although both rules mention patronage dividends, they refer to the issuer of the dividend, and not the recipient.

We find RCW 82.04.4281 to be more on point and it states:

In computing tax there may be deducted from the measure of tax amounts derived by persons, other than those engaged in banking, loan, security, or other financial businesses, from investments or the use of money as such, and also amounts derived

as dividends by a parent from its subsidiary corporations.

The Washington State Supreme Court held in Sellen Construction Co. v. Department of Rev., 87 Wn. 2d 878, that a deduction was allowed from the B&O tax under the predecessor of RCW 82.04.4281, if:

1. they [income] were amounts derived from investments and
2. the business activity did not constitute financial business.

Excise Tax Bulletin 505.04.109

The word dividend means "A share of profits received by a stockholder... ." The American Heritage Dictionary, Second College Edition Although a regular dividend is normally distributed based on the percentage of stock ownership, a patronage dividend is distributed based on the amount of purchases a stockholder has made during the year. Both, however, remain distributions of profits to shareholders.

Accordingly, the Department has consistently held that patronage dividends received by members or shareholders from co-operative buying associations are no different from other corporate dividends, and are deemed to be income derived from investments or the use of money as such. We further note that the taxpayer's activity which generated the income (ie. purchasing merchandise) does not constitute a financial business. Therefore, we find that the taxpayer is entitled to a statutory deduction from B&O taxes and that the tax under the Service and Other Activities tax classification was incorrectly assessed.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The file shall be returned to the Audit Section so that the appropriate adjustments consistent with this determination can be made and an adjusted assessment issued.

DATED this 9th day of May 1989.