

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

In the Matter of the Petition) D E T E R M I N A T I O N
For Correction of Assessment)
of) No. 89-437
)
 . . .) Registration No. . . .
) . . . /Audit No. . . .
)
)

RULE 111 AND RULE 203: B&O TAX -- ADVANCE AND REIMBURSEMENTS -- ATTORNEY OVERHEAD COSTS. Payments by individually incorporated lawyers to a jointly owned professional service corporation for overhead expenses are not excludable as advances or reimbursements from the business and occupation tax.

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 HEARING: August 17, 1989

NATURE OF ACTION:

The taxpayer petitions for the correction of an assessment of B&O service taxes for the period from January 1, 1984 through March 31, 1988.

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer is a law firm organized as a professional service corporation composed of individual incorporated lawyers. General operating and overhead costs were billed to the taxpayer who was liable for their payment. The individual corporations paid the taxpayer their share of the expenses and then the taxpayer paid those bills for the individual corporations. The auditor assessed B&O tax at the

service rate on the payments from the individual corporations to the taxpayer.

The taxpayer has appealed the assessment. While other correspondence is referenced, no legal authority is provided regarding the basis for the taxpayer's appeal. It requests any rulings that the department has published which the auditor relied on.

DISCUSSION:

RCW 82.04.220 imposes business and occupation taxes stating:

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

RCW 82.04.080 defines "gross income of the business" as:

"Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

The Department of Revenue has promulgated three rules which have application here: WAC 458-20-111 (Rule 111), WAC 458-20-203 (Rule 203), and WAC 458-20-207 (Rule 207). . . .

WAC 458-20-111 (Rule 111) provides an exclusion from gross income for "amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession." Rule 111 limits the applicability of the exclusion by defining the terms advance and reimbursement as:

The word "advance" as used herein, means money or credits received by a taxpayer from a customer or

client with which the taxpayer is to pay costs or fees for the customer or client.

The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.

The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily other than as agent for the customer or client. (Emphasis added.)

WAC 458-20-203 (Rule 203) requires each separately organized corporation to file a separate return. Each corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation or by the same individuals.

WAC 458-20-207 (Rule 207) discusses the application of various taxes to attorneys. Regarding the B&O tax and general overhead costs, Rule 207 states:

General overhead costs are includable in the tax measure even though an attorney may allocate those costs among particular clients. Likewise, any other costs for which an attorney assumes personal liability other than as stated above are includable in the tax measure.

Over the years the Department of Revenue has issued several Excise Tax Bulletins (ETB) which address situations similar to that of the taxpayer in this case. In ETB 90.04.203, the Department held that affiliated corporations could not deduct a portion of its costs attributable to a related corporation stating:

Under Rule 203 each separately organized corporation is a "person" irrespective of its affiliation with or relation to any other corporation and must file a separate return.

In ETB 424.04.203, the Department found that in circumstances where individuals engaged in separate business joined together to acquire equipment and share costs, a new taxable entity was

formed. The receipts of the new entity from the individual owners were subject to B&O tax even though the new entity's receipts only covered the costs of operation.

Expenses of a law firm are also addressed by the Supreme Court in Walthev v. Department of Rev., 103 Wn.2d 183, 189, 691 P.2d 559 (1984) which states on page 189:

The Department also expressed concern that the ruling we make today could allow a lawyer to allocate overhead expenses to a particular case in litigation and claim that reimbursements for those costs are likewise excluded from gross income. We disagree. A lawyer's general overhead costs, even though reimbursable, are not pass through costs because the lawyer assumes either primary or secondary liability to those types of providers. . .

Rule 111 makes this distinction by providing that such overhead costs are not exempt as advances or reimbursements even if allocated separately.

[N]o charge which represents . . a cost of doing or obtaining business, even though such charge is made as a separate item, will be construed as an advance or reimbursement. Money so received constitutes part of gross sales or gross income of the business, as the case may be. For example, no exclusion is allowed with respect to amounts received by . . . (5) any person engaging in a service business . . . for charges made separately for transportation or traveling expense

WAC 458-20-111. It is obvious that in overhead costs the attorney incurs primary liability and not liability solely as agent for the client . . .

While this case ultimately allowed a law firm to exclude reimbursements from clients regarding litigation costs which the firm incurred as agent, the statement regarding the taxability of overhead costs has been applied consistently by the Department in other businesses. See ETB 530.04.111 for further discussion of reimbursed client costs.

In addition, the structure of a business does effect its tax liability. Because the taxpayer is organized as a separate corporation, even though it shows no profits, it is still

taxable on the revenue it receives. ETB 424.04.203.
Transactions between a corporation and its stockholders or officers are as fully taxable as transactions between persons not so related. Administrative charges between affiliated corporations represent taxable income. ETB 90.04.203.

The taxpayer's receipts from the other service corporations for general overhead and other operating expenses are taxable. The taxpayer is not incurring these expenses as agent of the other corporations and is primarily liable for them. Therefore, no exclusion from gross income is available to the taxpayer.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 29th day of August 1989.