Cite as Det. No. 00-090, 20 WTD 500 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 00-090
	)	
. . .	)	Registration No. . . .

RCW 82.04.255; ETA 563: B&O TAX -- REAL ESTATE BROKERS -- DESK FEES. Amounts earned by a real estate broker from real estate associates for use of the broker's offices, equipment, and services are subject to the B&O tax rate specifically applicable to real estate brokers rather than the tax rate on royalties earned from granting intangible rights.

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:

A real estate broker seeks a refund of business and occupation (B&O) tax it claims to have overpaid by reporting its gross income under the service and other business activities tax classification rather than under the B&O tax classification for royalties earned from granting intangible rights to others.[1]

FACTS:

De Luca, A.L.J. -- The taxpayer is a real estate broker that has its headquarters and offices in the State of Washington. The taxpayer is a franchisee of a Washington-based franchisor, which entitles the taxpayer, among other rights, to use the franchisor's trade name and sales methods. In turn, the taxpayer has contracts with independent contractor real estate associates (associates) that allow the associates to operate out of the taxpayer's offices to provide real estate brokerage services to both buyers and sellers of real estate. The taxpayer uses two types of contracts with the associates. Some associates sign the Standard Agreement, while others sign the Fee Agreement (also known as the Desk Fee Agreement).

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

The Standard Agreement entitles the taxpayer to the gross commissions generated by the associates, and the taxpayer incurs most of the operating expenses. The taxpayer compensates the associates through advances and sharing the commissions. By law, the taxpayer pays B&O tax on the full commissions while the associates are normally not taxed on the subsequent distributions of their commission shares. RCW 82.04.255 and WAC 458-20-128 (Rule 128), *infra*. Tax on revenues received by the taxpayer under the Standard Agreement is not at issue.

Under a typical Desk Fee Agreement, the taxpayer receives the commissions and distributes all of them, in turn, to the associates who earned them, minus the associates' desk fees and expenses due the taxpayer. The associates pay the taxpayer desk fees for such things as access to the Multiple Listing Service, computers, printers, fax machines, local telephone service, office furnishings and space, voice mail, a receptionist, a secretary, etc. Expenses are incurred for items such as supplies, signs, advertising services, photocopies, mailings, referral services, and the use of sales materials. The associates owe the taxpayer the desk fees and expenses regardless of any commissions they earn or do not earn.

The taxpayer requested the Taxpayer Information and Education (TI&E) section of the Department of Revenue (the Department) to rule that the desk fee income, as of July 1, 1998 and afterward, was subject to tax under the royalties B&O tax classification as "franchise fees" per RCW 82.04.2907, i*nfra*. TI&E replied to the taxpayer by writing that the taxpayer did not have a franchise agreement with the associates selling them intangible property rights. Rather, TI&E stated the taxpayer was selling the associates both a license to use real estate (by providing office space) and support services. TI&E cited Excise Tax Advisory 563.04.128 (ETA 563) and ruled income from both types of activities is subject to the service B&O tax classification.

The taxpayer has appealed the TI&E ruling and seeks a refund of service B&O taxes it paid for the period beginning July 1, 1998, when RCW 82.04.2907 took effect, to the present.

TAXPAYER'S EXCEPTIONS:

The taxpayer cites several published determinations that have used standards such as "predominate nature," "primary activity," and "true object" to determine the appropriate B&O tax classifications by which taxpayers report their respective gross incomes. The taxpayer asserts the following determinations have employed such standards: Det. No. 92-183ER, 13 WTD 93 (1993); Det. No. 94-115, 15 WTD 19 (1995); Det. No. 89-474, 8 WTD 259 (1989); Det. No. 94-118, 16 WTD 11 (1994); and Det. No. 89-009A, 12 WTD 1 (1993). Accordingly, the taxpayer seeks a ruling that the "true nature" of the desk fees makes them royalties or charges in the nature of royalties. Therefore, the taxpayer contends the desk fees should be taxed under the royalties B&O tax classification per RCW 82.04.2907, rather than under the higher B&O tax rate for real estate brokers per RCW 82.04.255.

The taxpayer also cited several definitions of "franchise" in support of its initial argument that the desk fees are franchise fees. The taxpayer's definitions are derived from textbooks, Black's

Law Dictionary 658 (6th ed.), RCW 19.100.010(4) (the Franchise Protection Investment Act), and Det. No. 86-303, 2 WTD 43 (1986). According to the taxpayer, these definitions may encompass any or all of several types of activities. That is, franchisees can obtain the rights to sell a franchisor's products and to use a franchisor's trademark and trade name as well as its methods and expertise. Franchisees also can receive a franchisor's assistance in site location and construction, employee training, advisory services, and sales promotion and advertising.
In light of these definitions of franchise, the taxpayer references the section of the Desk Fee Agreement where the taxpayer provides the associates with desks, office equipment, local telephone services, support staff, etc. as described above. Additionally, that section of the agreement requires the taxpayer to assist the associates with its guidance, suggestions, and experience in matters of listings, sales, financing, current market trends, and general aspects of the real estate business. The agreement also requires the taxpayer to promote the image of the parties and office by establishing and maintaining rules regarding office use, the days it will be open, advertising, listing, and selling procedures and related matters.

The taxpayer explains it pays considerable franchise fees to a franchisor for the right to market homes using the franchisor's trade name and its well-established marketing system. For the standard agreement associates, the taxpayer concedes it is the franchisee and incurs all the business expenses. Therefore, the taxpayer is subject to tax on the full commissions and any payments for expenses it receives. By contrast, the taxpayer contends the tax consequences for its transactions with the desk fee associates are different. The taxpayer initially argued it had sublicensed its franchise rights to the desk fee associates who, it claimed, operate their own "sub-franchises" within the confines of the taxpayer's larger franchise. Consequently, the taxpayer contended the desk fee associates had acquired the use of the franchisor's trade name and system of selling by paying the desk fees to the taxpayer. Therefore, the taxpayer argued the desk fees are franchise fees and subject to the royalties B&O tax rate.

During our telephone conference, we alerted the taxpayer that it is unlawful under the Franchise Investment Protection Act (chapter 19.100 RCW) for franchisors or subfranchisors, with some exceptions, to sell franchises in Washington without registering with the Director of Financial Institutions. RCW 19.100.030. The taxpayer is a franchisee. It is not registered as a franchisor or subfranchisor.

Following the telephone conference, the taxpayer sent a letter to clarify its position. The taxpayer does not believe qualifying for the royalties B&O tax rate under RCW 82.04.2907 relies on a franchise status under chapter 19.100 RCW. The taxpayer explains the term "royalties" is defined broadly to include compensation for the use of intangible property, such as licenses, franchises, trade marks, trade names, and similar items. The taxpayer contends RCW 82.04.2907 does not require that intangible income necessarily relate to franchise fees. Instead, the taxpayer believes determining whether the desk fees qualify as royalties for the granting of intangible rights must be based on a comparison of the value of the specific items received by the associates in consideration for the desk fee.

The taxpayer believes the intangible items the associates receive, such as using the taxpayer's name on cards and signs, and its marketing approach, know how and training, far outweigh in value the tangible items the associates receive for their desk fees. While acknowledging it does provide some tangible support to the desk fee associates, as described above, the taxpayer contends such support amounts to no more than 20% of the average desk fee. The taxpayer arrived at the 20% figure after discussing the matter with "numerous 'executive suite' companies that provide similar services." The taxpayer argues the balance of the desk fees is attributed to intangible rights purchased by the desk fee associates. Accordingly, the taxpayer asserts the predominate nature or true object of the desk fees is that of a franchise agreement or the granting of another type of intangible right.

ISSUE:

Are the desk fees the associates pay the taxpayer subject to the royalties B&O tax classification for the granting of intangible rights to the associates or to the higher B&O tax rate for operating a real estate brokerage business?

DISCUSSION:

The Legislature lowered the B&O tax rate on royalties for granting intangible rights by passing SB 6449, which became effective July 1, 1998 and is codified as RCW 82.04.2907. Previously, royalties were taxed at the higher service B&O tax rate. RCW 82.04.2907 provides:

> **Tax on royalties from granting intangible rights.** Upon every person engaging within this state in the business of receiving income from royalties or charges in the nature of royalties for the granting of intangible rights, such as copyrights, licenses, patents, or franchise fees, the amount of tax with respect to such business shall be equal to the gross income from royalties or charges in the nature of royalties from the business multiplied by the rate of 0.484 percent.
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> "Royalties" means compensation for the use of intangible property, such as copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. It does not include compensation for any natural resource.

In its letter ruling, TI&E found the desk fee agreements were not franchise agreements because the business facilities and support services the taxpayer offers are not intangible property rights. TI&E relied in part on ETA 563 in reaching its decision that desk fees are subject to the service B&O tax rate rather than the lower royalties B&O tax rate. The Department issued ETA 563 originally on October 1, 1993 as Excise Tax Bulletin (ETB) 563 and then converted it without substantive change to ETA 563 on July 1, 1998; the same date RCW 82.04.2907 became effective. Like ETB 563, ETA 563 announces the Department's policy regarding real estate brokers and their shared commissions and expenses by providing in part:

> It is not unusual for brokers to make a charge to sales staff or associate brokers for providing space and other facilities such as telephone, advertising, multiple listing

> service, and office supplies. These charges may be a fixed amount per month or may be computed as a percentage of commissions or a percentage of sales. Generally brokers are subject to B&O tax on these charges, as well as on the gross commissions. The B&O tax applies to these charges even if the broker is simply attempting to recover the costs without markup which are incurred by having the sales staff or associate broker within the office. The recovery of these costs does not qualify as a nontaxable reimbursement under WAC 458-20-111 because the broker is not acting as the agent of the associates or agents in incurring the costs, but has primary or secondary liability to pay the provider of the supplies or services.

ETA 563 is consistent with Det. No. 90-360, 10 WTD 139 (1990), which resulted from an appeal by this same taxpayer. Similarly, the taxpayer in that case had standard agreements to split commissions with several associate real estate agents. Like the present matter, the Department and the taxpayer agreed the real estate commissions received by the taxpayer were subject to service B&O tax on the full amount of the commissions at the time the taxpayer received them. However, the taxpayer had another type of fee agreement with other associates. Instead of splitting commissions, the associates paid the taxpayer "nonrefundable monthly deposits" to cover their use of office space, services, and expenses. The Department ruled the payments were not commissions, but the taxpayer was still subject to service B&O tax on them as part of its gross income. The nonrefundable monthly payments, like desk fees in the present matter, were not contingent on whether the associate agents actually earned commissions. The payments were due the taxpayer regardless of the associates' earnings.

The taxpayer argues that the enactment of RCW 82.04.2907, which occurred after ETB 563 and 10 WTD 139 were issued, changed the way desk fees are taxed and therefore nullifies ETA 563. We disagree. ETA 563 announces that ETAs are advisory for taxpayers, but the Department is bound by them until superseded by court action, legislative action, rule adoption, or an amendment to or cancellation of the ETA. As noted, the Department converted ETB 563 to ETA 563 on July 1, 1998; the same day RCW 82.04.2907 took effect. Had the Department determined legislative action has superseded ETB 563, it would not have converted the ETB into the ETA, but would have cancelled it instead. ETA 563 continues to state the Department's policy toward real estate brokers and their shared commissions and expenses. Likewise, 10 WTD 139 remains in effect.

More importantly, the Legislature amended RCW 82.04.255, also effective July 1, 1998. The amendment reduced the B&O tax rate on real estate brokers from 1.75% of gross income of their business to 1.5%, the current service B&O tax rate. Otherwise, the statute contained the same wording that it had for several years. RCW 82.04.255 provides:

> **Tax on real estate brokers.** ***(Effective July 1, 1998.)*** Upon every person engaging within the state as a real estate broker; as to such persons, the amount of the tax with respect to such business shall be equal to the gross income of the business, multiplied by the rate of 1.5 percent.
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> The measure of the tax on real estate commissions earned by the real estate broker shall be the gross commission earned by the particular real estate brokerage office including

> that portion of the commission paid to salesmen or associate brokers in the same office on a particular transaction: PROVIDED, HOWEVER, That where a real estate commission is divided between an originating brokerage office and a cooperating brokerage office on a particular transaction, each brokerage office shall pay the tax only upon their respective shares of said commission: AND PROVIDED FURTHER, That where the brokerage office has paid the tax as provided herein, salesmen or associate brokers within the same brokerage office shall not be required to pay a similar tax upon the same transaction.

See also WAC 458-20-128 (Rule 128). The taxpayer contends the predominate nature or true object of its desk fee agreements with the associates is to grant intangible rights to the associates and entitle it to pay tax on the desk fees under the royalties B&O tax rate. Considering RCW 82.04.255, we find the Legislature has determined otherwise. The Legislature has specifically decided the *gross income* of a real estate broker's business is subject to the B&O tax rate of 1.5% and not the lower B&O tax rate for royalties. The desk fees are clearly part of the taxpayer's gross income earned from operating a real estate brokerage business. The taxpayer is not granting the desk fee associates intangible rights that are separate and apart from its real estate brokerage business.

The Washington Supreme Court has stated:

> We have previously held that where general and special laws are concurrent, the special law applies to the subject matter contemplated by it to the exclusion of the general law.

Washington v. Walls, 81 Wn.2d 618, 622, 503 P.2d 1068 (1972). *See also Washington v. Cann*, 92 Wn.2d 193, 197, 595 P.2d 912 (1979). RCW 82.04.255, and not RCW 82.04.2907, specifically applies to the gross income of real estate brokers received from engaging in the real estate brokerage business.

Had the Legislature decided that desk fees were subject to the royalties B&O tax rate, we believe the Legislature would have expressed such intent when it concurrently amended RCW 82.04.255 and adopted RCW 82.04.2907. Instead, the Legislature amended RCW 82.04.255 only to lower the B&O tax rate for real estate brokers, but not to exclude desk fees from that same B&O tax rate. As noted, RCW 82.04.255 has been in effect for many years with the same language. Only the rates were changed. The Legislature amended the statute in light of ETB 563 and 10 WTD 139, *supra*, each of which had publicly announced the Department's policy several years earlier to tax desk fees (a.k.a. nonrefundable deposit payments) under the service B&O tax classification.

Finally, we note there is no reference to desk fees in the legislative history to RCW 82.04.2907. We do not find the Legislature contemplated desk fees when it lowered the B&O tax rate on royalties or charges in the nature of royalties for the granting of intangible rights.

DECISION AND DISPOSITION:

The taxpayer's refund petition is denied.

Dated this 17th day of May, 2000.