State of Washington Department of Revenue

Excise Tax Advisory

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APPLICATION OF BUSINESS AND OCCUPATION TAX TOROYALTY INCOME EARNED THROUGH GRANT OF PATENT PRIVILEGES

Issued October 20, 1967

Is royalty income taxable under the "Service and Other Activities" classification of the Business and Occupation Tax when paid by an out-of-state manufacturer to the owner of a patent whose only place of business is in the State of Washington; or is the granting of exclusive patent privileges either a casual sale or an outright sale of capital assets either of which is tax exempt?

The taxpayer, a manufacturer and distributor, had granted an out-of-state manufacturer exclusive right to manufacture and to sell a patented piece of equipment in other countries and throughout the United States with the exception of several Western states, which territory was reserved to the taxpayer. Over a period of time the agreement was modified by the parties so that the franchise or license to use was extended for the life of the patent and it was agreed if the royalties did not equal a specified amount the license of the patent reverted from the "exclusive" to "non-exclusive" status.

The taxpayer protested Business Tax assessed under the "Service" classification upon the royalty income. He contended (1) there was no business activity giving rise to the income within the state, (2) that the income arose out of a casual sale or isolated sale and not as a part of the regular business activity, or (3) the transaction was a single outright sale of a capital asset because exclusive right had been granted for the life of the patent.

Published Rule 194 provides:

Persons engaged in a business taxable under the "Service and Other Business Activities" classification and who maintain places of business both within and without this state which contribute to the performance of a service, shall apportion to this state

ETBS have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.

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that portion of gross income derived from services rendered by them in this state. . . (Emphasis supplied.)

The Department ruled that the royalty income was entirely attributable to the taxpayer's activities and place of business in this state. The taxpayer had no place of business other than the State of Washington and, since patents are intangibles, the only situs which can be attributed to them is the commercial and/or legal domicile of the owner. In re Eilerman's Estate, 179 Wn 15.

The other two contentions raised by the taxpayer were rejected by the Department of Revenue because the contract contemplated varying payments, termination, modification, conversion and reversion and because the taxpayer had reserved territorial rights to himself. Consequently, the transaction was in effect a series of transactions involving exchange of rights to use in return for monetary payments and it was immaterial whether the patent could be characterized as a capital asset. See Gandy v. State, 57 Wn 2d 690.

The royalty income earned by the taxpayer under the contract was received as a regular, recurrent, and continuing part of the taxpayer's business. This activity clearly falls within the definitions of "business" and "engaging in business" (RCW 82.04.140, 150) and is not a casual or isolated sale made by a person who is not engaged in the business of selling the type of property involved as defined in RCW 82.04.040. (Order.)