Cite as Det. No. 96-046, 16 WTD 74 (1996)

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 96-046
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

1. RULE 109; ETB 571: B&O TAX -- INTEREST EXEMPTION -- CASH MANAGEMENT -- AFFILIATES. To determine the relative significance of investment earnings compared to a taxpayer's nonfinancial earnings in order to satisfy the first inquiry of ETB 571, a holding company may not include the revenue of separate affiliates in its percentage calculation.

1. RULE 109; ETB 571: B&O TAX -- INTEREST EXEMPTION -- CASH MANAGEMENT -- AFFILIATES. The second inquiry of ETB 571 is not met when all of a taxpayer's income is from investments and a substantial portion of that income is derived from regular investment activities.

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 holding company investing money received from its subsidiaries protests the assessment of business and occupation tax on its investment income.[1]

FACTS:

Pree, A.L.J. -- The taxpayer is the holding company of a group corporations. It provides centralized management to support the various operations of its subsidiaries. Its administrative support services include cash management, an investment function performed by three of its 120 employees.

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

The taxpayer requests a refund of business and occupation (B&O) taxes it paid on investment income for the period January 1, 1988 through May 31, 1995. The taxpayer contends that the investment income was exempt under Excise Tax Bulletin 571.04.146/109 (ETB 571) issued on June 30, 1995. Prior to the issuance of ETB 571, the taxpayer petitioned for an exemption of this investment income. The Interpretation and Appeals Division denied that request in a determination which addressed the taxpayer's current argument that its cash management activities were exempt. That determination covered the audit referenced in the heading above for the period from January 1, 1988 through December 31, 1991. We issued the determination on February 28, 1994. The taxpayer's petition for reconsideration was denied on January 31, 1995. The Department issued ETB 571 on June 30, 1995.

The taxpayer contends that the guidelines in ETB 571 justify a new review of the taxability of the taxpayer's investment income. The taxpayer derived the investment income at issue primarily on interest earned from the overnight deposit of funds it received pursuant to a cash management system, which it maintained for itself and for its affiliated, subsidiary companies (subsidiaries).

The cash management system was essentially a complex checking account in which the income from the subsidiaries was deposited and from which their expenses were paid. Each day the subsidiaries' accounts were "swept clean," thereby reducing their balances to zero. The balances were transferred to a concentration account maintained by the taxpayer. At the end of the day, the taxpayer invested the excess funds overnight in the concentration account from which the taxpayer received interest.

The taxpayer also received dividend income. Until June, 1990, an employee of the taxpayer engaged in futures and other commodities trading. The taxpayer intended that the trading provide a hedge against fluctuation in timber commodity prices. In addition, the taxpayer purchased a nominal amount of stock in competitors of its subsidiaries to obtain information from their corporate annual reports. The taxpayer states that this amount of dividend income was de minimis.

The taxpayer stresses that its investment activity was a small part of its activities. The employees of the subsidiaries made the operating decisions for the companies. The taxpayer made policy decisions and provided staff services such as legal, human resources, government relations, financial, treasury and philanthropy. The taxpayer centralized these services for consistency and efficiency. Other than the dividends and the interest, the taxpayer received nothing for these activities.

In its refund petition, the taxpayer originally compared its interest income to the total income of its subsidiaries. That ratio was less than half of one percent during the periods as shown:

	1988	1989	1990	1991
Interest	. . .	. . .	. . .	. . .
Total Income	. . .	. . .	. . .	. . .
Percentage	.259%	.335%	.416%	.109%

After the hearing, the taxpayer provided figures including dividends from its subsidiaries and other investment income. It computed the percentage of "financial" income to total revenue of all of its subsidiaries as shown:

1988	1989	1990	1991	TOTALS
. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .
3.514%	2.637%	5.4357%	2.965%	3.6762%

The Audit Division provided a copy of a worksheet used for the taxpayer's consolidated federal income tax return showing the taxpayer's[2] investment income including all of its dividends, and each entity's total revenue. Those figures showed that as a separate entity, all of the taxpayer's income was derived from investments. Unlike the subsidiaries, none of the taxpayer's income was derived from product sales.

In the alternative, if interest income was not exempt under the first inquiry (percentage test) of ETB 571, the taxpayer contends that the investment income was exempt under the second inquiry of ETB 571. The taxpayer states that its financial services were only a small part of its activities.

Finally, the taxpayer contends that the interest income was exempt under RCW 82.04.4281 because it was not a financial business. That same argument was previously addressed in the prior determination, and it was rejected. Therefore, we will not address it further.

ISSUES:

1.Under the first inquiry (percentage test) of ETB 571, may a parent corporation combine its income with that of its subsidiaries?

1.Under the second inquiry of ETB 571, may the interest income of a corporation be exempt when the only income it receives is the interest income from a cash management system and dividends from its subsidiaries?

DISCUSSION:

Excise Tax Bulletin 571.04.146/109 (ETB 571), issued June 30, 1995, clarifies the Department's position on the taxability of income from investments. It explains how RCW 82.04.4281 provides an investment income deduction in some situations. A two-part inquiry is used to determine if the taxpayer is a financial business. Regarding the first inquiry, the ETB provides:

The first inquiry requires determining whether the primary purpose and objective of the taxpayer is to earn income through the utilization of significant cash outlays or whether these activities are merely "incidental" to the taxpayer's nonfinancial business activities. This inquiry is made by applying a percentage test. The Department conclusively presumes that the income is not from engaging in a financial business, but is incidental to the nonfinancial business activities, if the financial income is five percent or less of the annual gross receipts. The percentage of financial income will be computed by including all calendar or fiscal year financial income from "loans and investments or the use of money as such" in the numerator, whether taxable, exempt, or deductible, and including all calendar or fiscal year revenues as normally measured by the B&O tax, including all revenues otherwise exempt or deductible, in the denominator.

If the first inquiry results in five percent or less of financial income in each of the years, it is unnecessary to proceed to the second inquiry. The taxpayer will not be considered as engaging in a "financial business". If the percentage exceeds five percent in any of the years, it is necessary to proceed with the second inquiry, but only for those years in which the percentage exceeds five percent.

In its petition, the taxpayer did not include dividend income as investment income. While dividend income of a parent from its subsidiaries is exempt under RCW 82.04.4281, that exempt dividend income is investment income and should be included when computing the percentage for the purpose of ETB 571. Following the hearing, the taxpayer submitted new figures which included dividends and computed the percentage by dividing its "financial income" by the gross revenue of all the subsidiaries.

[1] The Department does not combine the income of related entities. ETB 571 refers to a singular "taxpayer." WAC 458-20-203 (Rule 203) provides:

Each separately organized 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 by the same group of individuals.

Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of

[2] For the entity "Parent" separately.

consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

The tax liability of a corporation must be considered without regard to its relationship to a parent or subsidiary company or to the existence of common officers, employees, facilities, or stock ownership. American Sign & Indicator v. State, 93 Wn.2d 427, 429, 610 P.2d 353 (1980) citing Rena-Ware Distribs., Inc. v. State, 77 Wn.2d 514, 463 P.2d 622 (1970). While the taxpayer is a holding company of nonfinancial (wood product) businesses, that fact does not make the taxpayer itself a nonfinancial business. Similarly, a bank holding company is not necessarily a bank or financial business for the purpose of determining whether it can deduct income received from investments. See Rainier Bancorporation v. Department of Rev., 96 Wn.2d 669, 638 P.2d 575 (1982). Where a subsidiary, as a separate legal entity, had secured financial and competitive advantages by its separate existence, it was not in a position to ask that the separate corporate existence be disregarded at the expense of the state. Washington Sav-Mor Oil Co. v. Tax Comm'n, 58 Wn.2d 518, 523, 364 P.2d 440 (1961).

When we examine the taxpayer as a separate entity, we note that all of its income is investment income. The taxpayer does not meet the first test of ETB 571 requiring that its investment income be less than 5% of its total income. The taxpayers's investment income is not incidental to its earnings from other activities. To determine the relative significance of investment earnings compared to a taxpayer's nonfinancial earnings in order to satisfy the first inquiry of ETB 571, a holding company may not include the revenue of separate affiliates in its percentage calculation.

[2] ETB 571 provides a second test if the first test is not met:

The second inquiry for determining when a taxpayer's activities constitute a "financial business" involves whether the taxpayer's activities are similar to, or comparable to, those of "banking, loan, [or] security businesses", even though the taxpayer might not technically fall within one of those three categories. The factors which will be considered include, but are not limited to, the source of the income, frequency of investments, volume of investments, percentage of income from investments in relation to the total income of the business, and the relationship of the investment income to the other activities of the business.

The taxpayer invests all the money swept from its subsidiaries' accounts nightly. This activity is both regular and substantial. This income and the taxpayer's dividend income constitutes most of the taxpayer's income. The taxpayer is not otherwise paid for its activities. Therefore, we find that the taxpayer's activities constitute a financial business. Since the taxpayer does not meet either test in ETB 571, we deny the petition for refund.

DECISION AND DISPOSITION:

Taxpayer's petition for refund is denied.

The reporting instructions in this Determination constitute "specific written instructions" within the meaning of RCW 82.32.090. Failure to follow the instructions would subject the taxpayer to the additional ten percent penalty mandated by that statutory section.

This decision will become final April 19, 1996, unless you seek reconsideration of the decision or appeal the decision to the Board of Tax Appeals. If you decide to ask the Department to reconsider this decision, it is your responsibility to comply with the requirements for reconsideration contained in WAC 458-20-100(5). A copy of WAC 458-20-100 is enclosed with this decision.

You may appeal the decision to the Board of Tax Appeals (BTA). The BTA's appeal procedures are set forth in chapter 82.03 RCW, in chapter 456-09 WAC (formal appeals), and in chapter 456-10 WAC (informal appeals). It is your responsibility to comply with the statutory and administrative requirements to perfect your appeal to the BTA.

Alternatively, you may appeal the decision to Thurston County Superior Court. Your attention is specifically directed to RCW 82.32.180. It is your responsibility to comply with the requirements of RCW 82.32.180 in order to appeal the decision to Thurston County Superior Court. The Thurston County Superior Court is the only court in the state that has original jurisdiction to hear excise tax matters.

DATED this 19th day of March, 1996.