

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 98-035
)	
...)	Registration No. . . .
)	FY. . . / Audit No. . . .
)	
)	

RULE 111; RCW 82.04.080; RCW 82.04.140; RCW 82.04.220: B&O TAX -- BUSINESS -- ENGAGING IN BUSINESS -- GROSS INCOME. Amounts received by a union contractor to subsidize wages paid to its workers constitute gross income of the business subject to B&O tax. The subsidies were received as a direct result of the taxpayer being awarded a particular job, and thereby engaging in business activities. The union subsidies do not qualify as non-taxable advances or reimbursements because they do not meet all three requirements of Rule 111.

NATURE OF ACTION:

Union employer petitions for correction of assessment, arguing that “subsidies” received from the union should not be subject to tax.¹

FACTS:

C. Pree, A.L.J. (successor to Krebs, A.L.J.) -- The taxpayer was audited for the period of January 1, 1990, through June 30, 1994. The audit resulted in a total assessment of \$. . .

The taxpayer protests the assessment of service business and occupation (B&O) tax that was assessed with respect to “union subsidies.” The Audit Division stated that during the period of September 1992 through March 1994, the taxpayer received \$. . . , identified as “union subsidies” in its accounting records.

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

In addition to other union expenses, the union required the taxpayer to pay \$0.50 per hour per employee to a fund administered by the union. The fund is referred to as the “. . . Trust.” All union members who operate shops in a certain geographical area pay into the trust fund and can apply for money from the fund when bidding for a job against a non-union competitor. If the trust fund administrators accept a member’s request with respect to a particular job, the administrators agree to pay the member a labor hour amount up to a fixed sum. Thus, the union member can submit a lower bid for the job. If the member is awarded the job, the member must provide the trust fund administrators documentation supporting actual labor hours on the job. The administrators then issue a check to the member, based on the subsidized per labor hour amount.

The Audit Division noted that the union does not guarantee that a particular union member will receive any money from the fund. A particular member may receive no money, more than the amount paid in, or less than the amount paid in.

The taxpayer argues that its receipts from the trust fund are not income because the taxpayer pays into the fund, and the money is returned only when a job is awarded. Further, the taxpayer argues, other . . . union employers do not pay tax on these receipts.

ISSUES:

1. Whether the taxpayer’s receipt of the union subsidy results in gross income subject to the B&O tax.
2. Whether the Department is barred from assessing the tax because other taxpayers may not be paying tax on these amounts.

DISCUSSION:

[1] The B&O tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” Analytical Methods, Inc. v. Department of Revenue, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996), quoting, Palmer v. Department of Revenue, 82. Wn. App. 367, 371, 917 P.2d 1120 (1996). For purposes of the B&O tax, “business” is broadly defined to include

. . . all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

RCW 82.04.140. RCW 82.04.220, in turn, imposes the B&O tax on persons engaged in business. It provides:

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.

“Gross income of the business” is broadly defined by RCW 82.04.080 as:

. . . 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.

(Underlining ours.) Under these definitions and provisions, the taxpayer is engaged in business in Washington. Its gross income, including compensation for the rendition of services or other emoluments, is subject to B&O tax without any deduction on account of labor costs or any other expense paid or accrued. As noted above, gross income is defined broadly to include “emoluments however designated.” RCW 82.04.080. Further, in determining whether the taxpayer is entitled to an exemption or deduction for union subsidies received, we must narrowly construe the exemption and deduction statutes. See Lacey Nursing Center, Inc. v. Department of Revenue, 128 Wn.2d 40, 49, 905 P.2d 338 (1995); Analytical Methods, 84 Wn. App. at 241. Unless either (1) the union subsidies do not constitute gross income or (2) the union subsidies qualify for deduction, the taxpayer is subject to B&O tax on the subsidies.

A narrow exception to the definition of gross income is contained in WAC 458-20-111 (Rule 111), which addresses advances and reimbursements. Rule 111 provides:

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 the 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.

There may be excluded from the measure of tax 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.

The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

(Underlining ours.)

The Washington Supreme Court in Rho Co. v. Department of Rev., 113 Wn.2d 561, 567-68, 782 P.2d 986 (1989), listed the following three requirements to qualify for the exclusion set forth in Rule 111:

(1) the payments are customary reimbursements for advances made to procure a service for the client; (2) the payments involve services that the taxpayer did not or could not render; and (3) the taxpayer is not liable for paying the associate firms except as the agent of the client.

(Underlining ours.). The union subsidies do not qualify as non-taxable advances or reimbursements because they do not meet all three requirements of the rule as described in Rho. Specifically, the payments involve services the taxpayer rendered, i.e., the taxpayer is a . . . contractor that employed union workers. Furthermore, the taxpayer is liable for payment of its own employees' wages. Thus, the union subsidies are gross income of the business subject to the B&O tax. The subsidies were received as a direct result of the taxpayer being awarded a particular job, and thereby engaging in business activities. See Det. No. 93-136, 14 WTD 15 (1993)(amounts that independent contractors received as subsidies from the person for whom they performed work were subject to B&O tax).

The taxpayer argues that the union subsidies are similar to insurance proceeds. The taxpayer explains that the union subsidies, like insurance proceeds, are received only when a specific event occurs and are paid only to persons who have paid the premiums. However, insurance proceeds are generally received as the result of catastrophes, such as fire, storms, and flooding. These activities are not business activities, i.e., "activities engaged in which the object of gain, benefit, or advantage to the taxpayer." See RCW 82.04.140. In contrast, the union subsidies are paid directly as the result of the taxpayer's business activities.

Similarly, the union subsidies received by the taxpayer do not qualify as deductible contributions. See RCW 82.04.4282. Contributions require a "gratuitous purpose" that is not present in the union subsidies. See Analytical Methods, 84. Wn. App. at 243. As noted above,

the taxpayer receives the union subsidies as the direct result of its business activity; the subsidies are not gratuitous.

Further, we note that the taxpayer may not deduct the \$0.50 per hour the union requires be paid for each employee. These payments are simply a non-deductible cost of doing business. See RCW 82.04.080; Det. No. 93-136, 14 WTD 15 (1993)(amounts that a taxpayer paid to subsidize independent contractors who performed work for the taxpayer could not be deducted).

In summary, the taxpayer's receipt of union subsidies is subject to service B&O tax, and the taxpayer may not deduct the hourly amounts the taxpayer is required to pay to the union.

[2] The taxpayer next argues that other union . . . contractors are not paying tax on the union subsidies. However, a correct assessment cannot be overturned on grounds of selective enforcement. See Det. No. 93-16, 13 WTD 170 (1993); Det. No. 92-4, 11 WTD 551 (1992). In those determinations, we explained that the responsibility for properly reporting taxes rests on persons in business, not on the state, and that the fact that another taxpayer may not be properly reporting its taxes is not sufficient grounds for overturning a valid assessment. Thus, in this case, because we have determined that the assessment by the Audit Division was correct, we cannot overturn it based on a claim of selective enforcement.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. However, because the delay in issuing this determination was for the sole convenience of the Department, interest on the unpaid portion of the assessment will be waived for the period commencing January 18 1996 (the date that is one year after the taxpayer filed the petition for correction of assessment.)

DATED this 12th day of March, 1998.