

Cite as Det. No. 99-136E, 19 WTD 262 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>E X E C U T I V E</u> <u>L E V E L</u>
Assessment of)	<u>D E T E R M I N A T I O N</u>
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)	No. 99-136E
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)	Registration No. . . .
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[1] RULE 190; RCW 82.04.4286; RCW 82.04.030: B&O TAX – RETAIL SALES TAX -- BANKRUPTCY TRUSTEE – AGENCY OR INSTRUMENTALITY OF UNITED STATES – TAX IMMUNITY. Under the Supremacy Clause of United States Constitution, U.S. Const., Art. VI, cl. 2, a state may not directly tax the United States or any agency or instrumentality so closely connected to the United States that the two cannot realistically be viewed as separate entities. A bankruptcy trustee, whose primary role is to act as the representative of the bankruptcy estate, rather than the public at large or the United States, is not so closely connected to the United States that it cannot be viewed as a separate entity. Its gross income is not immune from B&O tax and its purchase of equipment is not immune from retail sales tax.

[2] RULE 190; RCW 82.04.4286: RETAIL SALES TAX -- BANKRUPTCY TRUSTEE – AGENCY OR INSTRUMENTALITY OF UNITED STATES – DIRECT TAXATION. A state can never directly tax the United States but is free to tax those private parties with whom the Government does business, even when the financial burden is passed on to the United States, so long as it is done without discrimination. A bankruptcy trustee's purchase of equipment is not immune from taxation although the financial burden may ultimately be passed on to the United States.

[3] RCW 82.04.368: B&O TAX – EXEMPTION – CREDIT COUNSELING SERVICES – BANKRUPTCY TRUSTEE. A bankruptcy trustee's duties include advising and assisting debtors in performing under debt repayment plans. Accordingly, the trustee provides some services similar to the services provided by nonprofit consumer credit counselors. However, a bankruptcy trustee's duties

and activities are far broader than the services provided by such counselors. Because most of the trustee's duties exceed the scope of the exemption, the trustee is not entitled to claim the exemption from B&O 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.

NATURE OF ACTION:

A taxpayer who operates as a trustee under Chapter 13 of the United States Bankruptcy Code contends that its income is not subject to business and occupation (B&O) tax and its purchase of equipment is not subject to sales or use tax.¹

FACTS:

Mahan, A.L.J. – Under 28 U.S.C. § 586(b), the Office of the United States Trustee, United States Department of Justice, appoints standing trustees for cases brought under Chapter 13 of Title 11 of the United States Bankruptcy Code. See 11 U. S. C. § 1302(a). The taxpayer was appointed by the United States Trustee to serve as a standing trustee in chapter 13 cases. As a Chapter 13 trustee, the taxpayer is paid on the basis of a percentage of funds paid into the Chapter 13 plan by debtors. 28 U. S. C. § 586(c).

The substantive duties of a Chapter 13 trustee are statutory in nature. By statute, the “role” of the Chapter 13 bankruptcy trustee is to act as “the representative of the estate.” 11 U. S. C. § 323(a). In general, the Chapter 13 trustee's duties include most of the duties of a Chapter 7 trustee, including being accountable for property and money received, furnishing information to creditors, filing reports with the court, and, if necessary, examining proofs of claims, objecting to claims, and opposing the debtor's discharge. 11 U. S. C. § 1302(b)(1). In addition, the Chapter 13 trustee has the duty to appear at hearings on the value of property, plan confirmation or plan modification, and “advise, other than on legal matters, and assist the debtor in performance under the plan”. 11 U. S. C. § 1302. Unlike a Chapter 7 trustee, the Chapter 13 trustee is not required to liquidate property and may not run the debtor's business.

The duties of standing trustees also vary between districts. Through local rules and orders, courts may impose additional administrative or substantive duties. For example, under the Local Rules of Bankruptcy Procedure for the Western District of Washington, the Chapter 13 standing trustee is responsible for sending notices of section 341 meetings and receives proofs of claims in Chapter 13 cases. See Rule 2002-1 and 2083-1 (1997). These are duties that are typically performed by the Court Clerk's office.

The United States Trustee supervises the administration of cases and trustees in cases under the various chapters of the United States Bankruptcy Code, including Chapter 13 cases and Chapter

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

13 trustees.² As part of its administrative duties, The United States Trustee reviews and approves the Chapter 13 trustee's budget, the trustee's compensation, and the percentage fee that debtors can be charged. U. S. Department of Justice, Executive Office of the United States Trustee, Handbook for Standing Trustees, p. 9-18 (1998). Except for a reserve account, a trustee can not carry over excess funds from one year to the next. Id. at 9-26. The United States Trustee must approve any purchase over \$2500. Id. Equipment and furniture purchased with Chapter 13 funds can be used only for the administration of Chapter 13 cases and by any successor to the standing trustee. Id. at 9-15.

In reviewing the taxpayer's budget for 1997, the United States Trustee's office questioned the line item for B&O taxes. Previously, the taxpayer paid B&O tax on its income. As a result of the United States Trustee's inquiry, the taxpayer requested a ruling from the Department of Revenue's (Department) Taxpayer Education and Information Section (TI&E). The taxpayer asserted that it was immune from B&O taxation as an instrumentality of the federal government and, alternatively, that the income was exempt from taxation as credit counseling services under RCW 82.04.368. By letter dated October 9, 1997, TI&E concluded the Department properly imposed B&O tax on the taxpayer's business.

The Department previously audited the taxpayer's business for the January 1, 1991 through December 31, 1994 period. In that audit, the taxpayer was assessed use tax on the purchase of equipment. The taxpayer had paid sales tax on the purchase of consumables, but not on equipment, because of an understanding that the equipment was, in effect, purchased for the federal government.

The taxpayer appealed TI&E's letter ruling. The taxpayer also seeks a ruling that it is immune from paying sales or use tax on the purchase of equipment or consumable supplies. The taxpayer is not seeking a refund of taxes paid under the previous audit.

At the hearing on appeal, the representative from the United States Trustee's office stated that the taxpayer was not considered an instrumentality or employee of its office. With respect to payment of local and state taxes, the U. S. Department of Justice, Executive Office of the United States Trustee, Handbook for Standing Trustees, p. 9-17 (1998) states:

With respect to the standing trustee operation, the standing trustee is required to file all appropriate tax reports with local, state and federal agencies and pay any amounts due. . .

² The role of the United States Trustee is described in the U. S. Department of Justice, Executive Office of the United States Trustee, Handbook for Standing Trustees, p. 1-3 (1998), as follows:

A major reason for the enactment of Bankruptcy Reform Act of 1978 was to remove the bankruptcy judge from the responsibilities for day-to-day administration of cases. Debtors, creditors, and third parties litigating against a bankruptcy trustee were concerned that the court, which previously appointed and supervised the trustee, may not be perceived to impartially adjudicate their rights as adversaries of that trustee. To address these concerns, judicial and administrative functions with the bankruptcy system were bifurcated.

. In many locations, the standing trustee is not subject to state and local property taxes, but the requirements may vary. The standing trustee is expected to pay any required state or local tax promptly.

No mention is made regarding locations where payment of state B&O taxes or use taxes may not be required. At the hearing, the representative from the United States Trustee's office stated he had polled other districts and had no response from anyone to the effect they were paying B&O tax. Some districts reported they were not paying sales or use taxes, but several districts indicated they were paying sales tax.

Rather than being an instrumentality of the United States Trustee, the taxpayer contends it is an instrumentality of the bankruptcy courts. In support of its position, the taxpayer provided copies of several letters, including a November 25, 1975 letter from the Administrative Office of the United States Courts to a California Chapter 13 trustee expressing the opinion that the Chapter 13 trustee is an "instrumentality of the bankruptcy court", an October 26, 1983 letter from the Tennessee Department of Revenue to a Tennessee Chapter 13 trustee stating that the trustee was entitled to a sales tax exemption as an "instrumentality of the government", and a May 25, 1989 letter from California's Board of Equalization to a California Chapter 13 trustee stating that the trustee, as an "instrumentality of the United States," was exempt from use or sales tax on the purchase of equipment.

ISSUES:

1. Is the taxpayer an instrumentality of the United States and, therefore, its income and its purchase of equipment immune from taxation?
2. Is the taxpayer's income exempt from B&O tax as consumer credit counseling services?

DISCUSSION:

The B&O tax is levied and collected from every "person" for the privilege of engaging in business in this state. RCW 82.04.220. A "person" is defined to include:

[A]ny individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

RCW 82.04.030 (emphasis added). Under RCW 82.04.4286, however, a deduction is recognized for business activity which the state is prohibited from taxing under federal law or the United States Constitution.

[1] The Supremacy Clause of United States Constitution, U.S. Const., Art. VI, cl. 2, has been interpreted such that a state may not "lay a tax directly upon the United States or upon any agency or instrumentality so closely connected to the United States that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." United States v. New Mexico, 455 U.S. 720, 735 (1982); United States v. City of Spokane, 918 F.2d 84 (1990).³ In New Mexico, the Court sustained a tax on the receipts of private contractors, and held that the mere fact that a contractor acts as an agent of the government does not mean that it is an agency or instrumentality of the government. To avoid paying state or local taxes, "a private taxpayer must actually stand in the Government's shoes." New Mexico, 455 U.S. at 736. The entities in question were not so integrated into the structure of the government that it was immune from tax. Id. at 738.

More recently, in California State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844 (1989), the Court held that the imposition of California's use tax on a bankruptcy liquidation sale held by a Chapter 11 trustee was not prohibited either by the intergovernmental tax immunity doctrine or by 28 U.S.C. § 960. With respect to tax immunity, the Court reasoned:

It is evident that whatever immunity the bankruptcy estate once enjoyed from taxation on its operations has long since eroded and that there is now no constitutional impediment to the imposition of a sales tax or use tax on a liquidation sale. There is no claim, nor could there be, that the tax discriminates against bankruptcy trustees or those with whom they deal. As Judge Augustus Hand observed on similar facts in 1936: "The purchaser at the judicial sale was only required to pay the same tax he would have been bound to pay if he had purchased from anyone else." In re Leavy, 85 F. 2d 25, 27 (CA2). Nor is the bankruptcy trustee so closely connected to the Federal Government that the two "cannot realistically be viewed as separate entities." United States v. New Mexico, *supra*, at 735. The bankruptcy trustee is "the representative of the estate [of the debtor]," 11 U. S. C. § 323(a); cf. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343 (1985), not "an arm of the Government," Department of Employment v. United States, 385 U.S. 355, 359-360 (1966), and the tax on the estate is an administrative expense of the debtor, not of the Federal Government, 11 U. S. C. § 503(b)(1)(B) (1982 ed. and Supp. V). Cf. Missouri v. Gleick, 135 F. 2d 134, 137 (CA8 1943). For the purposes of absolute tax immunity under the intergovernmental tax immunity doctrine, there is no material distinction between those municipal and state withholding and property taxes on the bankruptcy trustee which we have upheld, see Otte v. United States, 419 U.S. 43, 52-54 (1974); Swarts v. Hammer, 194 U.S., at 444, and the tax on the liquidation sale presented here.

Sierra Summit, 490 U.S. at 849 (footnotes omitted, emphasis added).

³ This principle has been recognized under WAC 458-20-190 (Rule 190). With respect to B&O taxes, it provides:

The United States, its departments, institutions and instrumentalities, including corporate instrumentalities, are not subject to tax under chapter 82.04 RCW.

Similar to the Chapter 11 trustee in Sierra Summit, the Chapter 13 trustee's role is to represent the estate (not the public at large or the United States) and it is not paid from federal funds to perform those services. Rather, it receives funds from fees imposed on debtors. This case is factually dissimilar in that Sierra Summit involved use tax imposed on the trustee's liquidation of the debtor's property, that is, a tax on estate property, not on the operation of the trustee's office itself.⁴ However, the reasoning used by the Court, that is, the bankruptcy trustee is not "so closely connected to the Federal Government that the two 'cannot realistically be viewed as separate entities'", appears to have equal application here. Accordingly, we conclude the imposition of the B&O tax on the gross income from the operation of the Chapter 13 trustee's office is not preempted from state taxation.⁵

We are also not persuaded by the taxpayer's argument that it is an instrumentality of the bankruptcy court. Our conclusion in this regard is supported by the reasons behind the Bankruptcy Reform Act of 1978. As discussed in fn. 1, supra, a major reason for the reform was to remove the court from the administration of cases and the trustee. Otherwise, debtors, creditors and third parties in proceedings against a bankruptcy trustee could perceive the court as not acting impartially in such proceedings. It would be inconsistent for us to then conclude that a trustee is a constituent part of the court (as the trustee contends) while, at the same time, it has the duty to appear as one of the parties before the court. In this regard, the case differs from ones where an entity has been found to be directly operated and controlled by the government for the general public benefit. See, e.g., Department of Employment v. United States, 385 U.S. 355 (1966) (American Red Cross); Det. No. 94-057, 16 WTD 160 (1994) (civil air patrol). Following Sierra Summit, one court has specifically stated that a bankruptcy trustee "is not a public official, officer or employee" because the trustee represents a select group of creditors and shareholders rather than the public at large. In Re Louis Rosenberg Auto Parts, Inc., 209 B.R. 668, 676 (Bankr. W.D. Penn. 1997).⁶

The taxpayer also cites Gagne v. Brush, 30 F. Supp. 714 (1940), which states, with little or no analysis, that a bankruptcy trustee is an "instrumentality of the United States." As discussed above, the taxpayer also submitted various letters that also describe the taxpayer as an instrumentality of the United States. Although of interest, this case and this material predate Sierra Summit and none of it addresses the central issue in this case; whether the Chapter 13 trustee is an "instrumentality so closely connected to the United States that the two cannot

⁴ In describing the Supreme Court's discussion and decision in Sierra Summit, one court has noted that "state taxes imposed on property of the estate or on business operations of a trustee do not violate principles of intergovernmental tax immunity. . ." In re United Constr. & Dev. Co., 135 B.R. 904, 909 (Bankr. D. Utah 1992) aff'd, 140 B.R. 573 (D. Utah 1992).

⁵ This conclusion is reinforced by the United States Trustee's manual, which instructs Chapter 13 trustees to pay any required state tax. Although it is the body charged with administering the Chapter 13 operations, it has not taken the position that such operations are preempted from state taxation.

⁶ See also J. Switzer, Note, 34 Hous. L. Rev. 1243, 1276 (1997) (Currently, the Code neither vests the bankruptcy trustee with title, the bankruptcy trustee is not really a trustee as the term is used in trust law, nor is the trustee a federal agent).

realistically be viewed as separate entities.” As discussed above, under the reasoning in Sierra Summit, we conclude the Chapter 13 trustee is not an instrumentality so closely connected to the United States so as to be viewed as the same entity.

[2] Having reached this conclusion, the analysis concerning sales and use taxes is comparatively straightforward. A state can never directly tax the United States but is free to tax those private parties with whom the Government does business, even when the financial burden is passed to the United States, so long as it is done without discrimination. New Mexico, 455 U.S. at 735-36; Washington v. United States, 460 U.S. 536, 544-545 (1983); see also California Credit Union League v. Anaheim, 95 F.3d 30, 31 (9th Cir. 1996); Rule 190.⁷ In this case, the United States does not directly purchase the goods, although the burden may ultimately be passed on to the United States. Further, the taxpayer has not made a claim of discriminatory treatment. Accordingly, the imposition of retail sales or use tax is sustained.

[3] The taxpayer also contends its income is exempt from B&O tax under RCW 82.04.368. This statute exempts the following services from the B&O tax:

This chapter [B&O tax] does not apply to nonprofit organizations in respect to amounts derived from provision of the following services:

- (1) Presenting individual and community credit education programs including credit and debt counseling;
- (2) Obtaining creditor cooperation allowing a debtor to repay debt in an orderly manner;
- (3) Establishing and administering negotiated repayment programs for debtors; or
- (4) Providing advice or assistance to a debtor with regard to subsection (1), (2), or (3) of this section.

In construing this statute, we start with the premise that statutes granting an exemption from taxation must be narrowly construed. As stated in Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 174- 75, 500 P.2d 764 (1972):

Exemptions to the tax law must be narrowly construed. Taxation is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it. Exemptions to the tax laws must be narrowly construed.

For purposes of this statute, we find the taxpayer to be a “nonprofit” organization. The statute does not limit its scope to organizations exempt from federal taxation under IRC § 501(c)(3), as some other nonprofit tax exemptions (see, e.g., RCW 82.04.367). Rather, we apply the general

⁷ With respect to retail sales tax, Rule 190 provides:

The retail sales tax does not apply to sales to the United States, its departments, institutions and instrumentalities, except sales to such institutions as have been chartered or created under federal authority, but which are not directly operated and controlled by the government for the benefit of the public generally.

definition of a “nonprofit” organization found in RCW 82.04.365 for purposes of construing the identical term in RCW 82.04.368. Because the taxpayer’s members do not receive any part of the gross income other than for services rendered, the taxpayer’s compensation is reasonable under the circumstances, and the taxpayer does not engage in political activity, it would be considered a nonprofit organization for the purposes of the exemption.

Because the taxpayer, by statute, has as part of its duties the duty to “advise, other than on legal matters, and assist the debtor in performance under the plan” (11 U. S. C. § 1302), it may provide advice to a debtor on establishing and administering a debt repayment plan. However, this is only one of the trustee’s many duties, both administrative and otherwise. For example, the trustee also gives notice to creditors, appears at hearings, processes proofs of claims, pays creditors from a trust account maintained by the taxpayer, acts as a liaison between debtors and creditors, and prepares documentation to present to the court. Moreover, by statute the primary role of the taxpayer is to act as “the representative of the estate.” 11 U. S. C. § 323(a). As such, it is not simply providing a consumer credit counseling service as envisioned by the statute. Rather, its duties and activities are far broader and exceed the scope of the exemption. The statute cannot be so broadly construed as to cover the duties of a standing trustee under Chapter 13 of the Bankruptcy Code. Accordingly, we sustain the denial of the exemption under RCW 82.04.368.

DECISION AND DISPOSITION:

The taxpayer’s petition is denied.

Dated this 19th day of May 1999.