

Cite as Det No. 99-023, 19 WTD 340 (2000)

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. 99-023
...	)	Registration No. ...
	)	FY ... /Audit No. ...

[1] RULE 194; RCW 82.04.460: B&O TAXES -- SERVICE & OTHER ACTIVITIES TAX -- SERVICES PERFORMED PRIOR TO ENTERING THE STATE -- MANAGEMENT. A Washington resident may exclude from B&O taxes receipts derived from management services performed at an out-of-state customer's location prior to entering Washington.

[2] RULE 194: B&O TAXES -- SERVICE & OTHER ACTIVITIES TAX -- SALE OF INTANGIBLE ASSET -- SITUS. Amounts received by a Washington resident from the sale of an intangible asset are allocated to the commercial domicile of the owner.

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 consultant and multi-level marketing distributor protests business and occupation (B&O) taxes assessed on income earned while she was residing and working in Nevada.<sup>1</sup>

FACTS:

Okimoto, A.L.J. -- . . . (Taxpayer) currently resides and operates an independent [product] distributorship located in . . . , Washington. Taxpayer was originally contacted by letter dated March 18, 1997 from an auditor in the Taxpayer Account Administration (TAA) Division of the Department of Revenue (Department). Based on information obtained during subsequent conversations, TAA determined that Taxpayer was doing business in Washington and was required to register with the Department. TAA sent a Master Business Application to Taxpayer on April 18, 1997. TAA then issued an audit assessment covering the period January 1, 1993 through December 31, 1996 for additional taxes, interest and penalties owing of \$ . . . and Doc.

---

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

No. FY . . . was issued in that amount on September 10, 1997. Taxpayer has protested the entire amount, and it remains due.

Taxpayer's accountant described Taxpayer's business activities in an August 6, 1997 letter as follows:

[Taxpayer] has been an independent distributor for [companies] since 1988 and has resided in the state of Washington since September 1, 1993. Only a minimal amount of product sales are generated in the state of Washington. [Companies] are based [outside Washington] and produce . . . products . . . outside the state of Washington. When she orders products from [companies], they ship them to her in Washington, collect the Washington sales tax based upon the suggested retail price and remits them to the state of Washington from [outside Washington]. She operates out of her residence on a mail order basis to other parts of the United States and globally. In addition, non-employee compensation received from the [companies] as shown on form 1099 are override commissions paid to her on sales by each of her sub level distributors. When she moved to [Washington], she was receiving annual commissions of \$22,000+ from sub distributors located throughout the world. These annual override commissions were based on sales activity prior to her moving to Washington. The sub-distributors were not from the state of Washington. Since she has moved to [Washington] she continues to receive these annual override commissions from these same sub-distributors from through out the world and a minimal amount from sub-distributors from the state of Washington. Her commissions and sales have not gone up to any appreciable extent since she has moved to Washington.

### **1099 Income:**

Taxpayer explained that she receives three types of 1099 income.

First, Taxpayer received 1099 income from . . . , a limited liability company [LLC]. Taxpayer objects to the service B&O taxes assessed on this income on the grounds that this is deferred income for services performed entirely prior to her relocation to Washington in September of 1993. Taxpayer argued in [her] petition:

. . . [Taxpayer] entered into an agreement with [Mr. Y] of [LLC] for payment of services rendered in years prior to 1992 in the State of Nevada, where [taxpayer] was a resident. These deferred compensations are not commissions from the sale of . . . Products nor related to carry-on of a business in the state of Washington. As a condition of her employment [taxpayer] resided in and managed the [companies] of Nevada. In addition she provided consultative services to [Mr. Y]'s sub-distributors. In exchange for [taxpayer]'s service she receives 10% of [Mr. Y]'s monthly income from [companies]. She provided services for [Mr. Y] since 1988 with little or no pay and negotiated an agreement with him in 1991 for past services due and services for 1991, 1992, and part of 1993. In 1993 she ended her relationship with [Mr. Y] and moved to [Washington]. The

agreement provides that she will still get paid 10% of [Mr. Y's] monthly salary until she has received \$1,000,000.

Taxpayer contends that this income is not related to the state of Washington or to Taxpayer's [Washington] business location. Taxpayer argued that she provided no services to [Mr. Y] after she moved to [Washington] and that this income should not be subject to Washington's B&O taxes simply because she reported it as business income on her federal return.

Taxpayer also received override commissions from [companies] on a 1099. This income was generated by her own sub-distributors. Taxpayer states that these sub-distributors are mostly located outside the state of Washington.

The third source of 1099 income is described in Taxpayer's petition as follows:

The 1099 received from [Mr. M] for \$23,060 in 1996 was money paid to [taxpayer] to purchase her "[companies] of sub-distributors" in [outside Washington]. This is considered a sale of an intangible asset. This does not relate to her [companies] sales activity or carry-on of a business in the state of Washington but pertains to previous [companies] sales activity [outside Washington] prior to coming to [Washington].

Deduction for Sales Tax collected:

Next, Taxpayer states that her Schedule C income on her federal income tax return includes some miscellaneous retail sales to consumers, upon which Taxpayer collected retail sales tax<sup>2</sup>. Taxpayer asks that she be allowed a deduction for the amount of retail sales tax included in her gross income from her Schedule C. Taxpayer states that she collects retail sales tax and pays it over to [companies] for reporting to the state of Washington.

Pro-rating of 1993 Income:

Taxpayer also states that the examiner assessed B&O taxes for all income received for the entire calendar year of 1993 even though Taxpayer did not reside in Washington until September 1, 1993. Taxpayer argues that, if it is taxable at all, this income should be pro-rated for the period Taxpayer lived in Nevada.

Apportionment vs. Separate Accounting:

Taxpayer also argues that she has separately accounted for her Washington retail sales. Taxpayer asks that the Department apportion any taxable 1099 income based on the ratio of Washington sales to out-of-state sales.

---

<sup>2</sup> Miscellaneous retail sales were \$3,209 in 1993

Finally, Taxpayer asks that she be allowed a small business credit under WAC 458-20-104 (Rule 104).

#### ISSUES:

- 1) May a Washington resident exclude from B&O taxes receipts generated by management services rendered to an out-of-state customer at a location outside the state of Washington and performed prior to entering Washington?
- 2) May a Washington resident exclude from B&O taxes receipts from the sale of an intangible asset?

#### DISCUSSION:

##### Pro-rating of 1993 Income:

RCW 82.04.220 imposes upon: “. . . 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.”

[1] In Taxpayer’s case, we believe that she is actually engaged in two or three separate business activities. First, she makes sales of . . . products at retail to consumers located both within and outside the state of Washington. Such sales are defined as retail sales under RCW 82.04.050 and are properly taxed under the retailing and retail sales tax classifications. If Taxpayer delivers these products to purchasers located outside the state of Washington, she may take an interstate deduction from the selling tax provided that she has retained the necessary documentation required by WAC 458-20-193 (Rule 193). Taxpayer has been engaged in this business activity since she first moved to Washington on September 1, 1993. However, to the extent that Taxpayer made sales, collected commissions, or received deferred income prior to entering the state, the business activities have occurred outside the state of Washington and are not subject to Washington’s B&O tax. Gwin, White & Price, Inc. v. Henneford, 305 U.S. 434 (1937). Taxpayer’s petition is granted on this issue.

##### **1099 Income:**

Taxpayer contends that this income, even though received while she resided in Washington, should be exempt from tax because it is not related to Taxpayer’s Washington business activities. Taxpayer argues that the income is solely related to services performed by Taxpayer entirely in Nevada.

RCW 82.04.460 requires the apportionment of income when:

Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such

services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

We first note, that apportionment is normally only required for persons rendering services taxable under RCW 82.04.290 and where the person maintains places of business both within and without Washington which contribute to the rendition of such services. WAC 458-20-194 (Rule 194). Apportionment is not appropriate where only one place of business contributes to the rendition of services. In addition, business activities that occur outside the state are not subject to Washington's B&O tax. Gwin, White & Price, Inc. v. Henneford, 305 U.S. 434 (1937). In respect to Taxpayer's income received from [LLC], we agree that Taxpayer's Washington place of business did not contribute in any way to the rendition of the services. The management services performed for [LLC] were rendered exclusively in Nevada prior to the time Taxpayer entered the state. Accordingly, Taxpayer's petition is granted on this issue.

[2] Next, we will address the [Mr. M] income. Taxpayer explained that these 1099 proceeds were derived from a sale of Taxpayer's right to receive payment for commissions generated by sub-distributors recruited and trained by her [outside Washington]. Taxpayer acknowledges that this was a sale of an intangible asset that occurred in 1996, after she had established her commercial domicile in Washington.

The Department has consistently followed the rule of law that intangible property has its situs at the domicile of its owner. Det. No. 92-004, 11 WTD 551 (1992); Excise Tax Advisory 324.04.106/194 (ETA 324); In Re Eilerman's Estate, 179 Wash. 1, 35 P.2d 763 (1934). Therefore, the state in which an intangible property owner is domiciled may impose a tax measured by the value of that property. Det. No. 88-233, 6 WTD 59 (1988). Since Taxpayer's domicile has been in Washington since September 1, 1993, Washington may and does impose its B&O tax on income received after that date. Taxpayer's petition is denied on this issue.

Next, we will address the override commissions received from [companies]. Taxpayer explained that this income is derived from Taxpayer's right to receive payment from sales generated by sub-distributors recruited and trained by her. However, Taxpayer has not provided a copy of her contract with [companies]. Therefore, it is unclear whether this compensation is for services rendered which may be apportioned under Rule 194, or for an intangible contract right that may not be apportioned. See also, WAC 458-20-246 (Rule 246). Based on the evidence submitted, we are unable to grant Taxpayer's petition. This issue is remanded to TAA for further investigation.

Deduction for Sales Tax collected:

The next issue we will discuss is Taxpayer's request that she be allowed a deduction for the amount of retail sales tax that she collected from her retail customers and included as gross receipts on Schedule C of her federal income tax returns. Taxpayer states that the retail sales taxes were paid to [companies] International, Inc. who remitted them to the Department<sup>3</sup>. WAC 458-20-195 (Rule 195) explains the deductibility of certain taxes. It states in part:

(C) OTHER TAXES. The amount of taxes collected by a taxpayer, as agent for the state of Washington or its political subdivisions, or for the federal government, may be deducted from the gross amount reported. Such taxes are deductible under each tax classification of the Revenue Act under which the gross amount from such sales or services must be reported.

This deduction applies only where the amount of such taxes is received by the taxpayer as collecting agent and is paid by the agent directly to the state, its political subdivisions, or to the federal government. When the taxpayer is the person upon whom a tax is primarily imposed, no deduction or exclusion is allowed, since in such case the tax is a part of the cost of doing business. The mere fact that the amount of tax is added by the taxpayer as a separate item to the price of goods he sells, or to the charge for services he renders, does not in itself, make such taxpayer a collecting agent for the purpose of this deduction.

RCW 82.08.050 requires that the retail sales tax be paid by the buyer to the seller. The seller is obligated to collect and hold the retail sales tax in trust for the state of Washington until remitted to the Department. Since the sales tax is not imposed on the seller it may be excluded or deducted from gross proceeds of sale, provided that it was originally included in the gross receipts figures recorded on Taxpayer's Schedule C. Taxpayer's petition is granted on this issue subject to verification by TAA.

Finally, Taxpayer's request for the small business credit allowed under Rule 104 is remanded to TAA for verification and/or adjustment.

#### DECISION AND DISPOSITION:

Taxpayer's petition is granted in part, denied in part and remanded in part.

Dated this 19<sup>th</sup> day of February 1999.

---

<sup>3</sup> Taxpayer submitted an affidavit from [companies] stating that it had collected sales tax from Taxpayer and remitted it to the Department on Taxpayer's behalf. It is Departmental policy to allow out-of-state multi-level marketers to collect retail sales tax from their Washington distributors and remit sales taxes to the state on the distributor's behalf. See, The Department of Revenue Answer Manual, Vol. 2, sec. 9 (1990).