Cite as Det. No. 99-121, 19 WTD 153 (2000)

BEFORE THE 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. 99-121
. . .	)	Registration No. . . .
	)	FY. . . /Audit No. . . .

[1] RULE 109: B&O TAX & RETAIL SALES TAX – FINANCING LEASE – INSTALLMENT SALE & FINANCE CHARGES. A leasing company that purchased equipment, resold the equipment to a customer on an installment basis and also received finance charge income was engaged in two separately taxable business activities.

[2] RULE 194: B&O TAX – APPORTIONMENT – OUT-OF-STATE BROKERS – SOLICITING BUSINESS & COORDINATION FINANCING ARRAINGEMENTS. A leasing company that utilized out-of-state brokers to solicit business, arrange and coordinate financing activities, and write up financing contracts was entitled to apportion its income.

[3] RCE 82.04.290: B&O TAX – FINANCIAL BUSINESS SEVICES TAX INSTALLMENT SALE & FINANCE CHARGES – LEASING COMPANY. A leasing company that purchased and resold equipment on an installment basis, and also collected finance charges on the remaining balances was not entitled to report its finance charge income under the new financial business services tax classification.

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 leasing company appeals from the assessment of additional business and occupation (B&O) taxes on financing leases.[1]

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

FACTS:

Okimoto, A.L.J. -- . . . (Taxpayer) is a leasing company based in . . . , Washington. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1990 through June 30, 1994. Because of time constraints, an estimated audit assessment resulted in additional taxes and interest owing of . . . and Document No. . . . was issued in that amount on December 14, 1994. After Taxpayer supplied additional documentation, the original assessment was amended and Document No. . . . was issued on July 7, 1995 in the amount of . . . . Taxpayer made partial payments and the balance remains due.

Taxpayer stated during the hearing that a typical financing lease transaction would occur as follows.

First, a customer contacts various manufacturers and evaluates the equipment. Once the desired equipment is found, the customer negotiates a price and strikes a bargain with the manufacturer.

Second, the customer contacts Taxpayer to arrange for financing the purchase price of the equipment.

Third, Taxpayer commits to supply money to finance the purchase.

Fourth, customer signs a lease with Taxpayer. The lease provides that at the expiration of the lease term, the customer has the option to purchase the equipment for $1.[2]

Fifth, the manufacturer delivers the equipment to the customer.

Sixth, the manufacturer invoices Taxpayer for the equipment. Title is transferred to Taxpayer and taxpayer pays the manufacturer. Taxpayer does not pay retail sales tax to the manufacturer.

Seventh, Taxpayer receives a downpayment from customer and reports the entire sales price as an installment sale (under the retailing B&O and retail sales tax).

Eighth, Taxpayer finances and charges interest on the remaining balance.

Ninth, the customer makes monthly payments to Taxpayer.

Tenth, Taxpayer books each payment on its books of account as both a return of principal and interest income.

TAXPAYER'S EXCEPTIONS:

[2]In some instances Taxpayer executes a true lease with customer. However, both Audit and Taxpayer agree on the proper procedure for reporting these transactions.

Taxpayer stated at the hearing that it objects to the manner that Audit analyzed its financing lease transactions. Taxpayer explained that Audit treated Taxpayer's financing lease activities as two separate transactions. First, a purchase and installment retail sale of the leased equipment, and second, a loan of principal with interest being charged on the outstanding balance. Under this analysis, Audit required Taxpayer to report and pay retailing B&O and retail sales tax on the entire sales price of the equipment at the start of the lease. In addition, Audit assessed service B&O tax on the interest earned on the outstanding principal.

First, Taxpayer disagrees with Audit's two-step analysis of its transactions. Taxpayer argues that there is only one transaction, a loan of money to the customer, which Taxpayer recovers through monthly lease payments. Taxpayer states that it makes no separate installment sale of the equipment to the customer.

Second, Taxpayer states that it incorrectly reported the principal portion of monthly payments under the service and other activities tax classification. Therefore, to the extent that it paid service B&O taxes on the return of principal, Taxpayer believes that it should be given a credit for overpaid B&O taxes. Taxpayer concedes that it did not report the interest portion of the payments.

Third, Taxpayer argues that it should be allowed to apportion the interest income earned to other states. Taxpayer testified at the hearing that although it has no out-of-state offices, it does contract with independent brokers located outside of Washington. Taxpayer stated that these brokers both solicit business, arrange and coordinate the financing activities, and actually write-up the financing contracts outside of Washington.

Fourth, Taxpayer argues that for periods after July 1, 1993 it should be allowed to report its interest income under the new financial business services B&O tax classification.[3] Taxpayer stated that it performs the same functions as a bank.

ISSUES:

1) When a leasing company purchases, resells, and finances capital acquisitions for a company, is it engaging in a single loan transaction or two separate business activities?

2) Where a leasing company uses independent brokers located outside the State of Washington to solicit business, arrange and coordinate financing activities, and write-up financing contracts is it entitled to apportionment?

3) Is a leasing company entitled to report financing lease income under the new financial business services tax classification?

DISCUSSION:

[3] The financial business services tax classification expired on July 1, 1998.

[1] In Courtright Cattle Co. v. Dolson Co., 94 Wn.2d 645, 619 P.2d 344 (1980), the Washington Supreme Court found a lease of equipment to be, in substance, an outright sale and disguised security agreement. Relying on that authority, the Department issued Determination No. 88-458, 7 WTD 75 (1988) and subsequently revised WAC 458-20-211 (Rule 211) to identify several factors to be considered when determining whether a lease is to be treated as an installment sale and disguised security agreement instead of a true lease. Because Taxpayer gives the lessee an option to purchase the equipment for $1 at the expiration of the lease term, both Audit and Taxpayer agree that the lease is not a true lease. The difference in opinion involves whether Taxpayer is making an installment sale of the equipment and disguised security agreement or just making a pure loan.

In Audit's response to Taxpayer's petition dated April 3, 1996 Audit explained its understanding of the facts regarding financing leases as follows:

> On the transactions involving Lease Agreements, [Taxpayer] enters into a formal Lease Agreement with its customers, where a lease term, number of payments, and amount of each lease payment including retail sales taxes is itemized. The equipment in these transactions is purchased for resale by [Taxpayer] without paying vendors the retail sales taxes. [Taxpayer] reports the income from Lease Agreements under the retailing and retail sales tax categories.
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> For the transactions involving Finance Leases, [Taxpayer] purchases equipment from vendors for resale without paying the retail sales tax, then sells the equipment to its customers, and then finances the amount of sale under a loan agreement. The principal loan amount in Finance Leases to customers includes the retail sales tax. [Taxpayer] reports these sales under the retailing and retail sales tax categories at the time of sale. The interest income generated from these loans have not been reported under the Business and Occupation taxes (Schedule 3 of the original audit report, and Schedules 2 & 3 of the adjusted audit report).

During the hearing, we specifically asked Taxpayer whether the supplier invoiced Taxpayer and whether title to the equipment was in Taxpayer's name or the lessee's name. Taxpayer was instructed to submit sample documentation, which we have not received. Absent documentation to the contrary, we conclude that the suppliers invoiced Taxpayer for the equipment and that legal title vested in Taxpayer's name.

Under these circumstances, even though we find that Taxpayer's finance lease transactions consist of a single sales transaction that transaction consists of two separately taxable business activities. WAC 458-20-109(4)(b). The first taxable business activity is the purchase and installment sale of equipment to the lessee. This transaction is subject to retailing B&O and retail sales tax on the selling price of the equipment at the time the lease is executed. WAC 458-20-198 (Rule 198). The second business activity is the relinquishment of the right to immediate payment of the sales price of the equipment and the collection of interest on the outstanding balance. Under WAC 458-20-109(2)(d), interest or finance charges received on installment sales are taxable under the service and other activities tax classification. Accordingly, Taxpayer's petition is denied on this issue.

However, we agree that the portion of Taxpayer's monthly payments solely attributable to the principal portion of the initial sales price is not subject to tax provided that Taxpayer has already fully reported the original sale. This issue is remanded to Audit for verification.

Apportionment:

We agree that Taxpayer's interest income or finance charges are derived from services that are more than incidentally rendered outside the State of Washington. See, Det. No. 94-031, 14 WTD 194 (1995) and Det. No. 93-276, 13 WTD 393 (1994). Therefore, we find that Taxpayer is entitled to apportion this income. See, Department of Rev. v. J.C. Penny Co., 96 Wn.2d 38, 633 P.2d 870 (1981). Accordingly, Taxpayer's petition is remanded to Audit for an apportionment based on the costs of doing business both within and without the state.

[3] Financial Business Services Tax Classification:

Effective July 1, 1993 the Washington Legislature amended RCW 82.04.290 and created a financial businesses services tax classification. It states:

> (2) Upon every person engaging within this state in banking, loan, security, investment management, investment advisory, or other financial businesses, other than or in addition to those enumerated in subsection (3) of this section; as to such persons, the amount of the tax with respect to such business shall be equal to the gross income of the business, multiplied by the rate of 1.70 percent.

Although Taxpayer acknowledges that it may not be included as "other financial institutions" under RCW 82.14A.010 . . . . Taxpayer argues that the new statutory language adopted in RCW 82.04.290(2) is significantly broader than the language contained in RCW 82.14A.010. Taxpayer points out that the language in RCW 82.14A.010 referred only to "other financial institutions" whereas, the new financial business services tax classification defined in RCW 82.04.290(2) applies to persons engaging within this state in ". . .banking, loan, security, investment management, investment advisory, or other financial businesses. . ." Taxpayer argues that this new definition is significantly broader and was intended to apply to all businesses that engaged in the business of making loans.

In construing statutes, the goal is to carry out the intent of the Legislature. Roy v. Everett, 118 Wn.2d 352, 823 P.2d 1084 (1992). The ejusdem generis rule of statutory construction requires that general terms appearing in a statute in connections with specific terms are to be given meaning and effect only to the extent that the general terms suggest items similar to those designated by the specific terms. In short, specific terms modify or restrict the application of general terms where both are used in sequence. Roy v. Everett, supra. Furthermore, to give effect to the intent of the Legislature, an ambiguous statute must be read as a whole and intent is not to be determined by a single phrase. Human Rights Comm'n v. Cheney Sch. Distr. 30, 97 Wn.2d 118, 641 P.2d 163 (1982). Applying this rule of statutory construction, to the phrase

"other financial business" that term must be read to include those persons engaged in activities similar to banking, loan, security, investment management, and investment advisory businesses. Although banking, loan, and security services may be performed primarily by financial institutions; investment management and investment advisory services can be performed by any person and not just financial institutions. We further note that when the legislature sought to specifically exclude services performed by financial institutions and certain investment management services from the selected business services tax classification, they did so in two separate subsections. RCW 82.04.055(2)(d) excludes investment management services and RCW 82.04.055(2)(f) excludes services performed by financial institutions. Based on these observations, we conclude that the financial business services tax classification contains two separate types of businesses, "banking, loan, security" and other financial businesses, and "investment management, and investment advisory businesses" and other similar investment management or advisory businesses.

In this case, Taxpayer is not engaged in investment management or advisory activities so, we must determine whether Taxpayer falls within the definition of "banking, loan, security . . . or other financial businesses". In Clifford v State of Washington, 78 Wn.2d 4, 8, 469 P.2d 549 (1970) the Washington State Supreme Court said:

> Making a loan and taking a land contract as security is not the same activity as selling a piece of land and accepting the payment in installments. In one activity, money is advanced. In the other, no money is advanced by the seller; rather he relinquishes the right to immediate payment.

Since we have found that Taxpayer is purchasing equipment and making installment sales of that equipment to customers, it is not making a loan but only relinquishing the right to immediate payment. Accordingly, we find that Taxpayer is not an other financial business within the meaning of RCW 82.04.290(2)[4] and may not report under the lower financial business services tax classification. Taxpayer's petition is denied on this issue.

DECISION AND DISPOSITION:

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

Dated this 30th day of April, 1999.

[4] After July 1, 1997 [the effective date of WAC 458-20-14601 (Rule 14601)],Taxpayer may qualify for the lower rate under the definition of "financial institution" contained in Rule 14601(j)(x).