Cite as Det. No. 90-86, 9 WTD 165 (1990)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 93-269ER, 14 WTD 153 (1995).

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. 90-86
. . .	)	Registration No. . . .
	)	. . . /Audit No. . . .

[1] RULE 109: RCW 82.04.4281 -- INVESTMENTS -- INTEREST --"INCIDENTAL INVESTMENT OF SURPLUS FUNDS" -- SALE OF ASSET. Receiving interest as a result of a decision to allow payments to be made over time is an not an "incidental investment of surplus funds" to qualify for the deduction available in RCW 82.04.4281. John H. Sellen Construction Co. v. Dept. of Revenue, 87 Wn.2d 876 (1976); Rainier Bancorporation v. Dept. of Revenue, 96 Wn.2d 669 (1982); and O'Leary v. Department of Revenue, 105 Wn.2d 679 (1986); Browning v. Department of Revenue, 47 Wn. App. 55 (1987); Donald F. Detlefsen v. State, Docket No. 84-38 (1985); Det. 88-169, 5 WTD 257, (1988).

[2] RULE 106: CASUAL AND ISOLATED -- SALE OF BUSINESS ASSET -- ONE-TIME-ONLY SALE. When the sale of a business asset, not originally intended to be offered for sale, was an isolated transaction, the receipt of the interest income by taxpayer is exempt from the business and occupation tax because the sale is a casual or isolated sale.

[3] RULE 245: TELEPHONE CHARGES -- RETAIL SALES TAX --RETAILING B&O TAX -- HOTEL -- SERVICES RELATED TO LODGING. When a hotel leases lines from several telephone carriers for the use of its employees and hotel guests, the charges to the guests are for services related to lodging and taxable as retail sales. This constitutes the activity of telephone service. Accord: 88-378; __ WTD ___ (1988); 88-378A __ WTD ___ (1989); 89-111, 7 WTD 191 (1989).

[4] RULE 178: USE TAX -- HOTEL RESERVATION SERVICE. The charge made for access to a hotel reservation service is not a charge made for the purchase of tangible personal property, but instead is a purchase of a service and not subject to use tax. Accord: 87-346, 4 WTD 267 (1987).

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF CONFERENCE: August 10, 1989

NATURE OF ACTION:

Taxpayer protests the assessment of tax on interest earned as a result of the sale of one of its hotels; use tax assessed on amounts it paid for access to reservation lines; the inclusion of amounts it paid for telephone lines in the taxable measure of its sales. Taxpayer also requested the use of a formula for calculating the proper amount of use tax due on consumable purchases.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer built and operated the [A] and [B] hotels. It also acted as a general contractor for other projects. Taxpayer states that it is no longer doing construction work. Its records were audited for the period January 1, 1984 through March 31, 1988. An assessment was issued for $XXX, which included taxes and interest. Taxpayer has paid $XXX on the assessment, which represented the unprotested part of the assessment.

At the time the petition was filed, taxpayer listed a number of factual disputes. Most of these have been resolved with the auditor. Only four issues remain for resolution.

I. Interest Income.

The first issue concerns the interest earned as a result of the sale of the [B] Hotel to [Chain B]. Taxpayer sold the hotel and took an interest-bearing note from the purchaser. The Audit Division assessed tax on the interest, relying on Excise Tax Bulletin (ETB) 422.04.109.146.

[Predecessor] built and operated what is now called the [Hotel A]. The [Hotel B], opened in 1980, was also built by [Predecessor]. [Predecessor] operated both hotels through a single telephone system, had intermingled accounting and personnel systems, and utilized a single computer system. The decision was made by the board of directors of [Predecessor] that the [Hotel B] had to be sold because of disappointing earnings and the general business climate in . . . in the early 1980s. At the time of the . . . sale, phone and computer lines had to be severed. [Predecessor] also had to pay a $500,000 penalty to break the franchise agreement between itself and [Chain A]. [Predecessor]

sold the [Hotel B] for a $XXX note bearing interest at . . . %, plus assumption of the existing mortgage.

In 1984, [Predecessor] merged with [taxpayer]., bringing the income from the note with it.

Taxpayer argues that the

> sale of the hotel and the loan of the purchase price to the borrower were incidental to the business ordinarily conducted by [taxpayer]. The interest derived from the note in question constitutes approximately 8% of [taxpayer's] annual gross receipts. In the last 15 years, [taxpayer] has not sold any of its other business properties.
>
> Subjectively, the arrangement with the Borrower was definitely an investment for [taxpayer] because the transaction was structured solely to reap financial advantages from the use of [taxpayer's] money. At an interest rate of . . . %, the note gives [taxpayer] a better return on the funds than it could receive if the Borrower had paid cash and [taxpayer] had invested the money in other investment vehicles offered by financial institutions. Moreover, the delay in payments over the term of the note allowed [taxpayer] to defer federal tax liability, thereby further enhancing [taxpayer's] overall financial picture simply through the choice of how to hold its nonoperating funds.

II. Telephone line charges.

The Audit Division assessed retailing B&O tax and retail sales tax on amounts listed as "equipment rental." Taxpayer argues that the amounts were actually "line charges" and were telephone access charges. Taxpayer leased lines from several different carriers. It pays a fixed rate for the lines, plus usage charges based on the number, length, and distance of the calls. Taxpayer argues that

> As stated on page 2 of the audit report, [taxpayer] acts as "agent for the guest" in regard to long distance telephone transactions, and thus must pay retail sales tax on only its gross margin derived for these calls, which constitutes, in effect, its commission. Long distance lines are part of the service that [taxpayer] procures as the guests' agent. Thus, the cost to [taxpayer] of the long distance line charges should also be subtracted from its gross revenues for the calls before tax is assessed.

Taxpayer argues that it would not incur charges such as "trunk fees" for long distance telephone lines if it

> didn't need so many lines to facilitate the guest's needs. The concept that the hotel is merely an agent or conduit facilitating a transaction between the phone company and the guest is certainly sound, however in order for the guest to make a long distance call, the lines must be paid for by the hotel to the phone company.

Taxpayer argues that the local calls should be taxed in the same manner as the long-distance calls.

III. Use tax on Reservation service.

The Audit Division assessed tax on charges made by [Chain A] for "communication access fees." These charges represent a monthly fee charged by [Chain A] for the reservation system.

> The system is used by people in other [Chain A] to make a reservation at the [Hotel A] by simply informing the front desk at the hotel where they are staying that they would like a [Hotel A] reservation. The charge for this service should not be subject to a use tax under RCW 82.12 because the service is not "tangible personal property" within the meaning of the statute. . .
>
> The only tangible personal property used in connection with the reservation service is a computer terminal and a printer. These items were purchased separately by the [Hotel A] . . .

IV. Assets purchased without tax.

The Audit Division assessed tax on assets purchased by taxpayer without payment of retail sales tax. Taxpayer requests that it be allowed to extrapolate the percentage of sales tax paid on the invoices representing renovation work done on the [Hotel A]. This work was done as a joint venture between taxpayer and [Affiliate]. Taxpayer and [Affiliate] are related entities; the vice-president of finance was the same between the companies; the procedures used to pay bills were identical; and the supervisory and accounting personnel were the same for all the companies. According to taxpayer, approximately one-half of the invoices were paid by the [Hotel A] directly, with the remainder being paid either by [Affiliate] or taxpayer's home offices. [Affiliate] is now in Chapter 7 bankruptcy, and its records are not available. However, taxpayer has assembled approximately 30% of the invoices. These invoices show that tax was paid on 94.8% of the invoices, and taxpayer therefore wishes to pay tax on 5.2% of the total amount owing on the remaining, unobtainable invoices. Taxpayer believes that this extrapolation is accurate, because "all three companies paid their bills in the same fashion."

DISCUSSION:

I. Interest Income.

For persons other than financial institutions RCW 82.04.4281 provides a deduction from the business and occupation tax for money derived from "investments or the use of money as such."

The history of this exemption, its application, and the court cases discussing it have been exhaustively discussed by the Department or the courts on a variety of occasions; we will not go into the history of the deduction and its application any further here.[1] Through these court cases, the

[1]See, for example, John H. Sellen Construction Co. v. Dept. of Revenue, 87 Wn.2d 876 (1976); Rainier Bancorporation v. Dept. of Revenue, 96 Wn.2d 669 (1982); and O'Leary v. Department of Revenue, 105 Wn.2d 679

test for whether income qualifies for the deduction is whether or not the money is earned as an "incidental investment of surplus funds" Sellen, at 883; because "[w]hether an investment is 'incidental' to the main purpose of a business is an appropriate means of distinguishing those investments whose income should be exempted from the B&O tax of RCW 82.04.4281." O'Leary at 682.

[1] Taxpayer argues that the arrangement with the buyer of the property was an investment because it received an interest rate greater than it could have obtained for its money elsewhere. It argues that it was incidental because it had not sold any of its other business properties in the last fifteen years and because the interest constitutes only . . .% of its gross receipts. Taxpayer cites a number of definitions of investment to prove that this note is an investment, including Black's Law Dictionary, other statutory provisions[2], accounting principles, and federal income tax law. Taxpayer also distinguishes its case from O'Leary and Browning. Browning, like O'Leary, found that the receipt of interest income from real estate contracts was not an incidental investment and was taxable. Taxpayer asserts that "it is in the business of building and operating hotels and other business properties, not of selling them and earning a return over time." Taxpayer contends that the sale was an extraordinary event, caused by financial strain and one which taxpayer does not wish to repeat. It charges that the Audit Division

> seems to be taking the view that, when a taxpayer chooses to take a note rather than total cash payment upon an isolated sale of a single piece of property, the taxpayer's interest in the note is not an investment.

Taxpayer claims that under this construction, any sale of real estate on a contract or a deed of trust basis would cause liability for B&O tax on the interest, making every individual selling his home on such a basis liable for the tax. According to taxpayer, the legislature could not have intended such a result "because the very purpose of the deduction is to preclude taxation of the isolated or incidental investment." Thus, taxpayer concludes that taxing any seller of a single piece of property is wrong.

We agree that the purpose of the deduction is to allow incidental investments of surplus funds to escape taxation. We do not agree, however, that the receipt of interest resulting from a decision to allow payments to be made over time is an "incidental investment of surplus funds." In Detlefsen, the Board of Tax Appeals followed Clifford V. State, 78 Wn.2d 4 (1970), and found that "interest income is a financing charge, it occurs by allowing payments to be made over an extended period of time and as a result, a fee or interest is realized; this does not meet the test of an investment." This case is no different from Detlefsen in that regard. Taxpayer's interest may qualify as an investment for other purposes; it does not meet the requirements set out by the courts for the deduction contained in RCW 82.04.4281.

(1986); Browning v. Department of Revenue, 47 Wn. App. 55 (1987); Donald F. Detlefsen v. State, Docket No. 84-38 (1985); Det. 88-169, 5 WTD 257 (1988).

[2]RCW 39.60.010, regarding investment of public funds; RCW 33.24.100 and RCW 32.20.040, regarding savings and loan associations and mutual savings banks ability to invest.

Taxpayer next argues that the interest should be exempt because the sale was casual or isolated. RCW 84.04.040 defines a "casual or isolated sale" as one made by a person "not engaged in the business of selling the type of property involved." WAC 458-20-106 (Rule 106) provides, in relevant part, as follows:

> . . . Any sales which are routine and continuous must be considered to be an integral part of the business operation and are not casual or isolated sales.
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> * * *
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> The business and occupation tax does not apply to casual or isolated sales.

[2] Among the factors used to determine whether sales are casual or isolated are whether more than one occurs and whether they are made as part of the business activity. The sale of an entire business is usually an isolated sale, since the regular course of the business is not selling businesses; but the sale of business assets may not qualify as casual or isolated sales, depending on the nature of the business and the items sold. See, e.g., Budget Rent-A-Car v. Department of Rev., 81 Wn.2d 171 (1972) (sale of automobiles used in car rental business were sales made by a person "engaged in the business of selling the type of property involved.") Further, the fact that the intent to sell the item may have been formed after the item was acquired does not necessarily make its sale casual or isolated; a taxpayer may change its business activities almost at will.

In this case, taxpayer was in the business of building and operating hotels. The integration of the systems of the two hotels shows that it was not built with the intention that it would be sold. The decision to sell was made later, when the financial strain became unacceptable. Taxpayer has sold no other properties. Under these facts, the sale of the hotel was an isolated transaction, and the receipt of the interest income by taxpayer is exempt from the business and occupation tax as a casual or isolated sale.

II. Telephone Line Charges.

Taxpayer argues that the amounts it pays for telephone line charges ought to be exempt of tax because it pays the amounts as "agents for the guests." In order to prevail on this argument, taxpayer must prove (1) that it had no real business relationship or involvement with any of the parties, the phone service, or the billing; and (2) that it did in fact merely pass through the funds received from its guests to the underlying telephone service providers. Taxpayer argues that it purchased the lines merely to facilitate its guests needs. Taxpayer claims that "the revenue from long distance charges is considered by the state to be a cost merely passed along by the hotel to the guest and the hotel is simply an agent between the guest and the phone company."

It is true that in 1983 the Department sent a letter to all hotels, motels and other lodging facilities regarding the tax on their billings to guests for the use of room telephones. That letter stated that the income received from guests for the charge made by the phone company to the hotel for each call would not accrue tax liability, but that the additional charges per call would be subject to retail sales

tax and retailing B&O tax, because under RCW 82.04.050(e) the term "sale at retail" or "retail sale" included the "sale of and charge made for the furnishing of lodging and all other services by a hotel. . . " (Emphasis added.)

[3] This case is different from the one discussed in 1983. A hotel is considered to be acting in an agency capacity where a phone company bills the hotel on a per-call basis, the hotel bills the guest for the actual charge as reported by the telephone operator, and remits that amount to the telephone company. Taxpayer bills its guests an amount greater than the actual call expense to pay for its costs. Taxpayer was obligated to pay for all long distance calls made, regardless of whether such calls were originated by the taxpayer or by its guests. The telephone lines are not segregated into guest lines and taxpayer's own lines. The taxpayer acquired the equipment and lines for its own needs in conducting its business activities and in order to solicit business and provide services to its guests.

Under WAC 458-20-245 (Rule 245), in relevant part provides:

> As used herein: The term "telephone service" includes competitive telephone service and network telephone service.
> The term "telephone business" means the business of providing network telephone service and includes cooperative or farmers line telephone companies or associations operating an exchange.
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> * * *
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> The term "network telephone service" means the providing by any person of access to a local telephone network, switching service, toll service, or coin telephone services, or the providing of telephonic, video, data, or similar communication or transmission for hire, over a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "Network telephone service" includes interstate service, including toll service, originating from or received on telecommunications equipment or apparatus in this state if the charge for the service is billed to a person in this state. "Network telephone service" does not include the providing of competitive telephone service, the providing of cable television service, nor the providing of broadcast services by radio or television stations.

In Det. 89-111, 7 WTD 191 (1989), the Department ruled:

> The taxpayer's business activity of providing to its customers access to a local telephone network is "network telephone service." The taxpayer's income from such business activity is subject to Retailing B&O tax measured by the amounts billed to the customer which includes the taxpayer's handling charge. There is no deduction from the measure of the tax for any of the taxpayer's expenses including amounts paid by the taxpayer for purchase of the telephone service, which the taxpayer resells to its customers/consumers, from local telephone companies.

Consequently, under Rule 245, the taxpayer owes Retailing B&O tax and retail sales tax on its telephone service revenues. The taxpayer, however, is entitled to a retail sales tax credit for any retail sales taxes paid by it to the underlying wholesale telephone service and network access providers on charges for calls by hotel guests. In the future, taxpayer is advised to provide resale certificates to its wholesale providers.

III. Use Tax on Reservation Charges.

[4] RCW 82.12.020 provides that the use tax applies to the use of any tangible personal property on which retail sales tax has not been paid. Taxpayer pays a fee for access to a reservation system. In other rulings, The Department has held that income from providing access to such a system is subject to the service classification of the business and occupation tax. (See Det. No. 87-346, 4 WTD 267 (1987)). The Department has taken the position that the provision of access to such a system is a service and not a sale of property. The purchase of such access is not subject to the retail sales tax or use tax, as it is not the purchase of tangible personal property.

IV. Assets Purchased without Tax.

Taxpayer argues that it should be allowed to pay tax on renovation invoices on a percentage basis, as it is not able to obtain the remainder of the invoices. We believe that the circumstances here may be such as to make this reasonable. Generally speaking, the taxpayer and the Audit Division jointly select test periods to be used determine tax liability. However, we remand this issue to the Audit Division to verify that the invoices are representative of the total invoices on the project. If the Audit Division is satisfied, from the records available, that such extrapolation is a reasonable approximation of tax liability, it may accept it as a reasonable method.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. The tax assessed on interest income shall be deleted, as will the use tax on the reservation system access fees. Taxpayer's petition is denied with respect to the telephone line charges. The matter of the extrapolation of the tax due on invoices is referred back to the Audit Division. The Audit Division shall issue a new assessment, to be due on the date stated therein.

DATED this 23rd day of February 1990.