

In The Matter of the Petition)		D E T E R M I N A T I O
N)		
For Correction of Assessment)		
of)	No. 90-163	
)		
. . .)	Registration No.	. . .
)	. . . /Audit No.	. . .
)		

Hesselholt, A.L.J. -- Taxpayer's books and records were audited for the period . . . through The above-captioned assessment was issued as a result. Taxpayer

protested the apportionment method used by the auditor, as follows:

The taxpayer maintains its books and records in a fashion that allows it to separately, on a state-by-state basis, apportion its gross income to the states from which the income is [derived]. Income from sources outside Washington is appropriately excluded (apportioned) from the Washington business and occupation tax.

* * *

The taxpayer fails to understand why the auditor arbitrarily insists that apportionment does not take place unless a cost apportionment is used. Clearly RCW 82.04.460. . . provides that separate accounting qualifies as the preferred method of apportionment absent special rules for financial institutions. The cost approach is merely given as an alternative in cases where separate accounting is not available.

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The word apportionment is generally defined as a division or allotment. The taxpayer has divided or apportioned out-of-state income by separately accounting for each item of income on a location-by-location basis. In previous audits the Department of Revenue has accepted the separate accounting apportionment method used by the taxpayer.

The Auditor's Detail of Differences states in part:

Your primary business activity is providing construction period mortgage loans to real estate developers. The properties which you loan monies on are located in Washington and various other states. On most of these loans, you appear as the first mortgagee on mortgage notes where the notes are secured by first deeds of trust. Along with the interest earned on these loans, you earn income though various other charges related to your business activity as itemized on schedule II. Your loans consist of a mix of residential and commercial loans where your participation as a lender is a full 100% or some percentage less [than] 100%. You have out-of-state business locations in some of the

states where you have provided mortgage loans. In addition to your instate office locations the functions of your out-of-state business locations are to solicit loans from developers, make loan proposals, arrange for appraisals, inspection of building sites, make loans, closing loans, review construction progress, and to submit all loan information to the companies' main office in The . . . headquarters office's functions are to approve all loans, provide all accounting functions, review all contracts and loans, writes all checks after review of loan documents and construction progress, and provide any other function that the out-of-state office location does not provide. Also, the . . . office headquarters performs those out-of-state office functions for loans in states where you do not maintain offices (. . .). The . . . office handles all loan functions for those transactions involving Washington properties. You have considered all income earned from out-of-state to be exempt from Washington's Business and Occupation taxes.

* * *

Since you have not apportioned out-of-state income in states where you have office locations, this schedule lists financing related income from all out-of-state locations. In states where you have offices, apportionment of income has been made on the basis which the cost of doing business within this state bears to the total cost of doing business both within and without this state (. . .). In states where you do not have office locations, no apportionment of income has been made.

DISCUSSION:

RCW 82.04.460 provides, in relevant part:

(1) 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.

(2) Notwithstanding the provision of subsection (1) of this section, persons doing business both within and without the state . . . who receive gross income from engaging in business as financial institutions within the scope of chapter 82.14A RCW (relating to city taxes on financial institutions) shall apportion or allocate gross income taxable under RCW 82.04.290 to this state pursuant to rules promulgated by the department consistent with uniform rules for apportionment or allocation developed by the states.

WAC 458-20-146 (Rule 146), is the Department's duly authorized administrative rule regarding the taxability of financial institutions. It does not make any provision for the apportionment of income. Thus, the Department relies on WAC 458-20-194 (Rule 194) to determine the proper apportionment of income. That rule provides, in relevant part, as follows:

When the business involves a transaction taxable under the classification service and other business activities, the tax does not apply upon any part of the gross income received for services incidentally rendered to persons in this state by a person who does not maintain a place of business in this state and who is not domiciled herein. However, the tax applies upon the income received for services incidentally rendered to persons outside this state by a person domiciled herein who does not maintain a place of business within the jurisdiction of the place of domicile of the person to whom the service is rendered.

* * *

Persons engaged in a business taxable under the service and other business activities classification and who maintain places of business both inside and outside this state which contribute to the performance of a service, shall apportion to this state that portion of gross income derived from

services rendered by them in this state. Where it is not practical to determine such apportionment by separate accounting methods, the taxpayer shall apportion to this state that proportion of total income which the cost of doing business within this state bears to the total cost of doing business both within and without this state.

For purposes of apportionment under RCW 82.04.460 and this rule the term "place of business" generally means a location at which regular business of the taxpayer is conducted and which is either owned by the taxpayer or over which the taxpayer exercises legal dominion and control. The term does not include locations or facilities at which the taxpayer acquires merely transient lodging nor does it include mere telephone number listings or telephone answering services.

Taxpayer states that it maintained "separate accounting methods" under the rule; the Audit Division believed that there was no separate accounting as is intended by the rule. Words used in a statute (or rule) must be given their ordinary meaning unless a contrary intent appears. King County v. Seattle, 70 Wn.2d 988, 425 P.2d 887 (1967). "Separate accounting methods" must be considered to mean exactly what it says: a method of accounting that separates the Washington income from the other income.

The determination of "separate income" is not as simple as it sounds. In Department of Rev. v. J.C. Penney Co., 96 Wn.2d 38 (1981), Penney alleged that all its finance charge income took place out of state and therefore it was beyond the reach of Washington's taxing jurisdiction. The Department attempted to tax the service charge income received by Penney on its credit sales to Washington residents. The underlying sale took place in Washington, but the decision to authorize credit purchases is made in Portland; all billing is handled in Portland, and the Portland office deals with credit problems. The court found that the income was taxable, because it found that taxpayer's local activities "which promote the sale on credit are sufficient to bring the finance charge income within the taxing statute." J.C. Penney, at 44.

In Rena-Ware Distributors, Inc. v. Washington, 77 Wn.2d 514 (1970), the Supreme Court found that the "business activity of servicing installment accounts falls naturally within this definition [of engaging in business within Washington], and it

is our conclusion that the legislature intended that this activity should be taxed under this section. . . " Rena-Ware, at 516.

In this case, taxpayer makes loans to out-of-state entities. Taxpayer has some out-of-state offices, but does do some businesses in states in which it has no actual office of its own. Taxpayer approves all loans and disburses all checks out of its Washington headquarters; these activities contribute to taxpayer's earning and receipt of income from other states. In order to satisfy the requirements of RCW 82.04.460 and Rule 194, any apportionment method must accurately describe the amount of income derived from Washington activities and that derived from out-of-state activities. If taxpayer can show that its separate accounting methods accurately and adequately show the amounts of income derived from activities within this state, its separate accounting methods will be considered acceptable. An accurate and adequate division from income is not made by simply attributing all the income from a loan to the place where the loan was made when activities that significantly contribute to the production of income, such as loan approval, take place in this state and are not accounted for. If taxpayer's accounting methods do not meet this test, it must use a cost method of apportionment.

The cost method used in the audit is incorrect, however. No apportionment was allowed in the locations where taxpayer did not have an office location. Apportionment cannot be denied simply because a taxpayer does not maintain a place of business outside this state. Det. 87-186, 3 WTD 195 (1987). Costs are to be attributed to the location of the office or place for which the expenses were incurred.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part.

DATED this the 13th day of April 1990.