Cite as Det. No. 99-063, 24 WTD 1 (2005)

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. 99-063
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 105; RCW 82.04.360: B&O TAX--EMPLOYEE EXEMPTION—INDEPENDENT CONTRACTORS. The B&O tax does not apply to income earned by an employee or servant as distinguished from that of an independent contractor. Whether a person is acting as an employee or as an independent contractor is determined by an examination of various factors, with the employer's right to control the employee being the most important factor.

[2] RULE 194; RCW 82.04.460: APPORTIONMENT–NEXUS—INCIDENTAL SERVICES PERFORMED OUTSIDE THE STATE. Taxpayers who provide services both within and without the state may, under certain circumstances, apportion their gross income. Maintenance of a place of business outside this state is not a prerequisite for apportionment, provided the services are more than incidental. In order for such activities to be more than incidental, the taxpayer must have taxable nexus where the services are performed. When a taxpayer incidentally works outside Washington while attending trade shows does not establish taxable nexus in such states, the income is not subject to apportionment.

[3] RULE 194: APPORTIONMENT--ROYALTIES--COMMERCE CLAUSE--MOBILIA SEQUUNTUR PRESONAM DOCTRINE. The Department allocates this state's gross receipts tax on royalty income to a taxpayer's commercial domicile, in accordance with the *mobilia sequuntur personam* doctrine.

NATURE OF ACTION

Taxpayer contends he was an employee, not an independent contractor, and protests the assessment of service business and occupation (B&O) tax on his income. He further protests the assessment of B&O tax on his income from royalty payments.[1]

FACTS:

Mahan, A.L.J. – The taxpayer is an editor and writer of articles and books on computer-related subjects. He receives royalties from the publication of his books. He is also the owner of a small software company that makes add-ons or plug-ins for certain software products. In 1987 he took a job as a senior editor of a magazine, which had its offices in . . ., Canada. At that time, he relocated the software company to the state of Washington. His duties as senior editor included the writing of monthly articles, planning the content of future issues, editing the work of others, and representing the magazine at trade shows.

In 1991 the magazine was sold to an [out of state] company. At that time the taxpayer was offered the opportunity to relocate [out of state] or to become an independent contractor. The taxpayer chose to become an independent contractor and to reside in the state of Washington. He negotiated an increase in his monthly salary to compensate for the loss of benefits. The taxpayer began reporting for federal income tax purposes income from the magazine under a Schedule C, Profit or Loss from a Business, as reported on a Form 1099 from the magazine for non-employee compensation.

As an independent contractor his duties remained the same, at least initially. He continued to work as a senior editor of the magazine and to represent the magazine at trade shows. During 1991 through 1993, rather than being in the office on a daily basis, as he had done in the past, he spent one week a month at the [out of state] offices in order to attend editorial meetings and plan future issues. According to the taxpayer, during 1994, 1995, and 1996, he became more "marginalized."

He spent less time [out of state] in 1994 and no time in 1995 and 1996. His association with the magazine ended after 1996.

From 1991 through 1993, the taxpayer worked under an oral agreement with the magazine. In 1995 and 1996 he worked under the terms of written agreements. The written agreements provided for the taxpayer to complete a specified number of monthly and feature articles of certain lengths, by certain dates. The topics were not identified and the taxpayer was allowed to

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

set his own hours. No mention was made of editorial or planning obligations. The agreements further provided for a monthly salary and for the reimbursement of travel and other expenses.

While residing in Washington the taxpayer continued to receive royalty payments for works completed while he was not a resident of Washington. While a resident of Washington, he entered into a contract with the magazine's publisher for publication of a book. He also entered into contracts, dated in 1996 and 1992, with other publishers for book publications. He also signed addenda in 1992 for special editions of previously published works. Under each of these agreements, the taxpayer received royalty payments.

In 1996, the Department of Revenue (Department) audited the taxpayer's software company. For purposes of convenience, the taxpayer had used the company's accounts to process and account for reimbursements from the magazine. The taxpayer volunteered to the Department that he had other income from working as a senior editor for a magazine and from royalties from book sales. The Department then audited the taxpayer individually and assessed B&O tax on income from the magazine and from royalties. Because the taxpayer was not previously registered, the Department's assessment went back seven years and late-payment penalties and interest were added. The Department allowed apportionment of the income based on time spent at the magazine's [out of state] offices, but not while the taxpayer attended trade shows in other states, under the conclusion that such activity was incidental in nature.

The taxpayer appeals the assessment and contends that he was legally an employee and not an independent contractor of the magazine. To the extent he was an independent contractor, the taxpayer asserts that trade-show activity, which accounted for as much as 10% if his time, should be apportioned. He further contends the state cannot assess B&O tax on his royalty income because it was earned from activities performed outside the state. In support of this contention, the taxpayer refers to Ch. 82.56 RCW. Finally, the taxpayer contends that, having volunteered information, he should not be penalized by late-payment penalties or the assessment of interest.

ISSUES:

1. Was the taxpayer an independent contractor or an employee when he worked as a senior editor?

2. If he was an independent contractor, should income from attending trade shows in other states be apportioned?

3. Was the royalty income the taxpayer received while a resident of Washington subject to B&O tax?

4. Should interest and penalties be waived as a result of the taxpayer's good faith in volunteering information to the Department?

DISCUSSION:

1. Employee or Independent Contractor.

The Revised Code of Washington provides an exemption from the B&O tax for income earned by an employee or servant as distinguished from that of an independent contractor. RCW 82.04.360. The determination of one's status as either an employee or an independent contractor is a question of fact that must be based upon the particular facts and circumstances of each case. Hollingbery v. Dunn, 68 Wn.2d 75, 80, 411 P.2d 431 (1966). In Hollingbery, the court examined whether the employer had actual control or right to control over the employee and whether the employee was actually in business.[2]

In order to address the factors to be considered in determining employment status, the Department adopted WAC 458-20-105 (Rule 105). See also Det. No. 93-107, 12 WTD 621 (1993).[3] With respect to the factors indicating that a taxpayer is an independent contractor, Rule 105 provides:

> (3) **Persons engaging in business**. The term "engaging in business" means the act of transferring, selling or otherwise dealing in real or personal property, or the rendition of services, for consideration except as an employee. The following conditions will serve to indicate that a person is engaging in business.
>
> If a person is:
>
> (a) Holding oneself out to the public as engaging in business with respect to dealings in real or personal property, or in respect to the rendition of services;
>
> (b) Entitled to receive the gross income of the business or any part thereof;
>
> (c) Liability for business losses or the expense of conducting a business, even though such expenses may be ultimately reimbursed by a principal;
>
> (d) Controlling and supervising others, and being personally liable for their payroll, as part of engaging in business;
>
> (e) Employing others to carry our duties and responsibilities related to the engaging in business and being personally liable for their pay;

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[2] The Hollingbery court defined an " employee" as follows:

> A servant or employee may be defined as a person employed to perform services in the affairs of another under an express or implied agreement, and who with respect to his physical conduct in the performance of the service is subject to the other's control or right of control.

Id. at 79.

[3] Rule 105 provides that an employer's right of control is the most important factor, as follows:

> (2) While no one factor definitely determines employee status, the most important consideration is the employer's right to control the employee. The right to control is not limited to controlling the result of the work to be accomplished, but includes controlling the details and means by which the work is accomplished.

(f) Filing a statement of business income and expenses (Schedule C) for federal income tax purposes;

(g) A party to a written contract, the intent of which establishes the person to be an independent contractor;

(h) Paid a gross amount for the work without deductions for employment taxes (such as Federal Insurance Contributions Act, Federal Unemployment Tax Act, and similar state taxes).

With respect to the factors indicating a person is an employee, Rule 105 provides:

(4) **Employees**. The following indicate that a person is an employee:

If the person:

(a) Receives compensation, which is fixed at a certain rate per day, week, month or year, or at a certain percentage of business obtained, payable in all events;

(b) Is employed to perform services in the affairs of another, subject to the other's control or right to control;

(c) Has no liability for the expenses of maintaining an office or other place of business, or any other overhead expenses or for compensation of employees;

(d) Has no liability for losses or indebtedness incurred in the conduct of the business;

(e) Is generally entitled to fringe benefits normally associated with an employer-employee relationship, e.g., paid vacation, sick leave, insurance, and pension benefits;

(f) Is treated as an employee for federal tax purposes;

(g) Is paid a net amount after deductions for employment taxes, such as those identified in subsection (3)(h) of this section.

In this case, the factors that favor treating this taxpayer as an independent contractor arose out of the following facts: (1) the magazine did not treat the taxpayer as an employee for federal income tax purposes; (2) the taxpayer filed a Schedule C for federal income tax purposes; (3) he was paid a gross amount without deductions; (4) he was a party to written contracts that establish him as an independent contractor; (5) he was not paid fringe benefits; (6) and he was liable for his business expenses, although he was reimbursed for those amounts. In addition, the taxpayer controlled the details and means of completing his work, including his hours and place of work. The contracts set general parameters as to length of articles and when articles were due, otherwise the taxpayer had significant control over his work, including the content of the work and how and when it was completed.

Factors that favor treating the taxpayer as an employee arose out of the following facts: (1) the taxpayer did not hold himself out to the public as being in the business of writing magazine articles; (2) he had no employees; (3) he continued to do the same work as he did when he was an employee, at least initially; and (4) he received a monthly salary.

In considering these various factors, on balance we find that the taxpayer was an independent contractor. Of particular significance in this regard was the negotiation between the taxpayer and the magazine over compensation as an independent contractor and the degree of control the taxpayer exercised under the written contracts. Accordingly, we sustain the assessment in this regard.

2. Apportionment of Income from Attending Trade Shows.

The B&O tax is imposed on all business activities in the state of Washington. The tax is measured by the taxpayer's gross income of business. RCW 82.04.220. The term "gross income of the business" includes compensation for rendition of services without any deduction on account of costs, expenses, or losses. RCW 82.04.080.

Taxpayers who provide services both within and without the state may, under certain circumstances, apportion their gross income. RCW 82.04.460; Det. No. 92-262E, 12 WTD 431 (1992).[4] Maintenance of a place of business outside this state is not a prerequisite for apportionment, provided the services were more than incidental. Det. No. 88-476, Det. No. 89-553.[5]

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[4] RCW 82.04.460 provides:

> (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.
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> (2) Notwithstanding the provision of subsection (1) of this section, persons doing business both within and without the state who receive gross income from service charges, as defined in RCW 63.14.010 (relating to amounts charged for granting the right or privilege to make deferred or installment payments) or 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.

[5] In Det. No. 92-262E, the apportionment requirement was discussed as follows:

> The second prong of Complete Auto is fair apportionment. This is required to prevent undue burdens on interstate commerce and to prevent the taxation of extraterritorial values. We concur that apportionment is required when a tax paying business conducts revenue producing activities both within and outside the state. See: RCW 82.04.460 quoted above and Rule 194. However, apportionment is only required when the other state has the constitutional ability under Complete Auto to tax the business' activities. There is no requirement to apportion when the other state is unable to constitutionally tax the gross receipts business. The concept of apportionment is designed to assure that, on a theoretical basis, an interstate business is taxed on no more than 100% of its receipts. Container Corp of America v. Franchise Tax Bd., 463 U.S. 159, 169 (1983). This does not mean that every state must provide an identical apportionment methodology, Moorman Manufacturing Co.

The Department, however, is required to apportion income only if the taxpayer has "commerce clause nexus" with Washington and another state. See Complete Auto Transit v. Brady, 430 U.S. 274 (1977), where the U.S. Supreme Court announced the test to determine the validity of state taxation of interstate business under the Commerce Clause of the U.S. Constitution. The relationship between commerce clause nexus and apportionment was also discussed in Det. No. 92-262E as follows:

> The first requirement of Complete Auto is that the taxpayer has nexus with the state seeking to impose the tax or in this case the state which the taxpayer believes could impose the tax. We find that the test for meeting the nexus requirement is the same as the test to determine if a party is doing business in the affected state.

Like Det. No. 92-262E, the present taxpayer provided services for his client, in part, by travelling from Washington to out-of-state locations where he attended trade shows. Once trade shows were completed, the taxpayer returned to his Washington office, where he continued work for his client. We find the out-of-state activities at trade shows were only incidentally rendered in relation to other work completed in Washington for his client. Accordingly, we hold the fact that the taxpayer incidentally worked outside Washington at times does not mean the taxpayer was doing business in those states and, therefore, it does not establish taxable nexus with those states. Consequently, the law does not require Washington to apportion the taxpayer's gross income from trade show activities.

3. Royalty Income.

In this case the taxpayer received royalty income from granting the rights to copy and publish his work. Such rights are considered intangible rights. In general, intangible rights include "patents, stocks, bonds, goodwill, trademarks, franchises, and copyrights." Black's Law Dictionary at 726 (5th ed. 1979).[6] The taxpayer was assessed B&O tax under the "catch-all" provisions of the service

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> v. Bair, 437 U.S. 267 (1978), rather it means that the apportionment methodology must be internally and externally consistent. Container Corp. of America, supra. By internal consistency the Courts have meant that the apportionment method must be such that if all states use the identical taxing scheme, no more than 100% of the gross receipts from the same income producing activity would be taxed.
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> The Washington apportionment formula must account for all costs of doing business. If the Washington business conducts no activities outside the state, then there is no need to apportion. However, if the Washington business is directly and actively engaged in business both within and outside the state, then the issue becomes where should the costs are (sic) attributed.

[6] Subsequent to the period at issue, a special rate category for royalty income was adopted. RCW 82.04.2907 provides:

> Upon every person engaging within this state in the business of receiving income from royalties or charges in the nature of royalties for the granting of intangible rights, such as copyrights, licenses, patents, or franchise

and other activities classification, RCW 82.04.290. The tax was assessed because the taxpayer had income from the use of intangible rights, not because it had income from performing services.

As discussed above, income from engaging in multi-state services and from the use of certain rights (involving service charges and financial institutions) may be apportioned. By its terms, RCW 82.04.290 requires the apportionment of certain income from the rendering of services both outside and inside the state. At no place does it require the apportionment of income from intangible rights. At issue here is income from the granting of intangible rights, not from the rendering of services both inside and outside Washington.

The Multistate Tax Compact, Ch. 82.56 RCW, however, does have provisions concerning the allocation and apportionment of income from intangibles. Under Article IV of that Compact, business income, including income from patents and copyrights, is apportioned using a three-factor formula. Non-business income is allocated to the state where the intangible is used, with a throwback provision to the taxpayer's commercial domicile. See generally Dexter, Taxation from Intangibles of Multistate-Multinational Corporations, 29 Vand. L. Rev. 401, 407 (1976).

Article IV of the Compact, however, is not applicable here for several reasons. First, it specifically applies only to the apportionment of "net income". RCW 82.56.010. Because Washington does not impose a net income tax, it is not applicable to this state's tax structure. Also, the Article is broad in scope and utilizes a three-factor formula to apportion all income; there does not appear any basis to selectively apply it only to income from intangibles. As such, it would conflict with apportionment formulas for certain B&O taxes under RCW 82.04.460. Accordingly, the Compact does not require Washington to apportion franchise fees or other intangible rights.

Rather than apportioning income from intangibles, the Department allocates such income to the taxpayer's commercial domicile, under the doctrine of mobilia sequuntur personam (movables follow the person). That doctrine has been used to create a fictional situs of such property in the domicile of the owner. As stated in Hellerstein & Hellerstein, State Taxation § 9.09 (2nd ed. 1993), with respect to income from copyrights and other intangibles:

> Under the principle of mobilia sequuntur personam, royalties and other payments for the use of patents, copyrights, trade names, and similar intangibles formerly were deemed in some States to be attributable to the commercial domicile of the owner of the property and were, accordingly, allocated to that State, unless the property had a acquired a business situs in another State, in which event the receipts were allocated to that State. [Footnotes omitted.]

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fees, the amount of tax with respect to such business shall be equal to the gross income from royalties or charges in the nature of royalties from the business multiplied by the rate of 0.484 percent.

"Royalties" means compensation for the use of intangible property, such as copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. It does not include compensation for any natural resource.

With the adoption of the Compact by many states, however, "[s]uch rules no longer obtain in most states." Id. That has not been the case in Washington.

This state has relied on the doctrine in various contexts. See, e.g., Granite Equipment Leasing Corp. v. Hutton, 84 Wn.2d 320, 325, 525 P.2d 223 (1974); In re Eilermann's Estate, 179 Wash. 15, 16, 35 P.2d 763 (1934); O'Keefe v. Department of Rev., 79 Wn.2d 633, 635, 488 P.2d 754 (1971). By analogy to this case law, the Department has held that, for B&O tax purposes, intangible rights follow the situs of the commercial domicile of the owner. See, e.g., Det. No. 88-233, 6 WTD 59 (1988); Det. No. 92-004, 11 WTD 551 (1992).

The taxpayer's commercial domicile is in Washington. The royalty income he receives is allocated to this state for B&O tax purposes. Accordingly, we sustain the assessment as to royalty income.

4. Waiver of Penalties or Interest.

The taxpayer also seeks to have the Department waive or cancel the interest and penalties that have been assessed. The authority to waive penalties or interest for the late payment of the business and occupation tax is limited. The assessment of penalties for the period at issue was governed by RCW 82.32.090, which provided in relevant part:

> If payment of any tax due on a return to be filed by a taxpayer is not received by the department of revenue by the due date, there shall be assessed a penalty of five percent of the amount of the tax; and if the tax is not received within thirty days after the due date, there shall be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within sixty days after the due date, there shall be assessed a total penalty of twenty percent of the amount of the tax.

RCW 82.32.050 similarly provides that interest "shall" be assessed when less tax is paid than what is properly due. The use of the word "shall" in the statutes indicates that the imposition of penalties and interest for late payment is mandatory.

RCW 82.32.105 for the period at issue provided for the waiver or cancellation of these penalties and interest under certain conditions, to wit:

> If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any interest or penalties imposed under this chapter with respect to such tax. The department of revenue shall prescribe rules for the waiver or cancellation of interest or penalties imposed by this chapter.

WAC 458-20-228 (Rule 228) is the administrative rule promulgated by the Department in accordance with this provision. Rule 228 sets forth seven circumstances considered "beyond the

control of the taxpayer" for purposes of waiving penalties. It also provides two circumstance considered "beyond the control of the taxpayer" for purposes of waiving interest. None of these circumstances apply here.

In essence, the taxpayer is asserting that he assumed, incorrectly, he did not need to pay tax on his income from royalties and from working as an editor. The failure to make an inquiry or to determine one's own tax liability is not a circumstance beyond a taxpayer's control. Det. No. 92-006, 11 WTD 56 (1992); Det. No. 86-299, 2 WTD 035 (1986). Lack of knowledge, no matter how innocent, has never been considered a circumstance beyond the taxpayer's control. Under RCW 82.32A.030(2) a taxpayer has the responsibility to:

> Know their tax reporting obligations, and when the are uncertain about their obligations, seek instructions from the department of revenue; . . .

In reaching this decision we have no doubt that, had the taxpayer known of his obligation earlier, he would have registered and paid his taxes.[7] We appreciate taxpayer's cooperation with the Department once he learned of his tax reporting obligations. We have no authority or discretion, however, to abate interest and penalties.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 22nd day of March 1999

[7] Had the taxpayer, prior to being contacted by the Department, voluntarily registered and made a good faith attempt to report correctly, the assessment would have been limited to four years plus the current year, rather than seven. WAC 458-20-230(3).