Cite as Det No. 12-0191, 32 WTD 188 (2013)

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. 12-0191
. . .	)	
	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	

RULE 135; RCW 82.04.2907, RCW 82.04.290: SOURCING THE SALE OF INTANGIBLE PROPERTY – ROYALTIES. Income from the sale of Alaska individual fishing quotas (IFQs) is subject to the service and other activities B&O tax classification, and as an intangible, is sourced to the domicile of the seller under the doctrine of *mobilia sequuntur personam*.

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.

Munger, A.L.J. – Taxpayer protests an assessment of service and other business and occupation (B&O) tax, arguing that its income from the sale of individual fishing quotas for the privilege of fishing in Alaska should be sourced to the state where the natural resources are located.[1] Based on the doctrine of *mobilia sequuntur personam*, and on the Taxpayer's Washington domicile, the petition is denied.[2]

ISSUE

Whether income from the sale of Alaska fishing privileges, which are intangibles, should be sourced to the domicile of the seller or the location of the natural resources?

[1] [This appeal addresses sales of individual fishing quotas occurring prior to June 1, 2010. We note that effective June 1, 2010, section 105, chapter 23, Laws of 2010 1st sp. sess. changed Washington's method of apportioning gross income from royalties. *See also* WAC 458-20-19403.]

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

FINDINGS OF FACT

As part of the Magnuson Fishery Conservation and Management Act, the federal government implemented an IFQ (Individual fishing quotas) program in 1995 for sablefish and halibut fisheries off the coast of Alaska. IFQs allocate privileges to harvest a certain portion of the total allowable catch of a given fishery to individuals or groups of individuals to address the issue of overfishing without direct regulation. Quota shares were originally assigned to vessel owners or leaseholders who made at least one landing in any one of the years 1988, 1989, or 1990. The intent was to assign initial shares only to those fishermen then currently active in the fisheries.

[Taxpayer] qualifies for these IFQ shares on an annual basis. A person that owns quota shares may sell his annual shares. [Taxpayer] has for years been in the business of selling these IFQs through a broker located in Washington State.

Although the Taxpayer used [an out-of-state] address, the Department found during the audit period that the Taxpayer had a Washington residence as well as a business in Washington. Additionally, all the payments from the sale of the IFQs were deposited in a local Washington State bank . . ., and the Closing Statements from the broker also used a Washington address for the seller, the Taxpayer. As such we find that [Taxpayer] was domiciled in Washington State during the audit period.

The Audit Division conducted a limited scope desk examination of Taxpayer's records for the period January 1, 2007, through June 30, 2010. During the audit period, Taxpayer sold $. . . in IFQs. On October 5, 2011, the Audit Division issued a $. . . assessment, which included service and other activities B&O tax in the amount of $. . . on unreported income from the sale of IFQs, a delinquent return penalty in the amount of $. . ., a five percent (5%) assessment penalty for substantial underpayment of the tax due in the amount of $. . ., a 5% unregistered business penalty in the amount of $. . ., and interest in the amount of $. . . . The assessment is unpaid.

The Taxpayer objects to Washington taxing this income because it believes the income should be sourced to the state where the natural resources are located in the waters off Alaska. It also asserts that contrary to the audit findings, that the Taxpayer has no nexus with the State of Washington. Audit had stated in its report that the Taxpayer's use of the Washington broker created nexus with Washington State. Taxpayer also asserts that a number of events support a finding that Alaska is the proper state to source this income to. These include the execution of some of the sale documents outside of Washington. The issue here, however, is not one of nexus, but where Washington taxes the recipient of income from intangibles, a sourcing question.

ANALYSIS

The Washington Business and Occupation (B&O) tax is broadly defined as including all activities engaged in with the object of gain, or benefit, to the taxpayer. RCW 82.04.220. RCW 82.04.140. RCW 82.04.290 states that persons engaged in any business activity, other than or in addition to those for which a specific rate is provided in Chapter 82.04 RCW, are taxable under the service and other activities tax classification. For income taxable under the service and other activities classification, the tax is levied on the gross income of the business. *Id.* "Gross income of the business" means:

> the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, . . . gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, ***royalties***, ...

RCW 82.04.080. (Emphasis added)

In Washington, there are two different tax treatments of IFQs depending on whether they are leased or sold. Income from the outright sale of an IFQ, as occurred here, is considered the sale of an intangible asset under the RCW 82.04.290 service and other activities classification. Income from the use or lease of royalties is subject to the lower B&O rate allowed by RCW 82.04.2907.

Taxpayer objects to Washington taxing its IFQ sales income because it believes the income should be sourced to the state where the natural resources are located in the waters off Alaska. It asserts that Washington has always sourced the sale of rights to natural resources to the location of the natural resources. In support of its position, Taxpayer cites RCW 82.04.2907 (tax on royalties), WAC 458-20-135(5) (extracting mining or mineral rights), and former WAC 458-61-520, later promulgated as WAC 458-61A-112 (Mineral rights and mining claims). . . .

The Rule 135(2) definition of "extractor" "*…also includes any person who takes fish, shellfish, or other sea or inland water foods or products."* (Emphasis added). Clearly Rule 135 requires that to be an extractor, the person must actually "take" the fish or natural resource. Here, the IFQs is an intangible right, the right to take fish, but not the actual taking of fish. The purchasers of the Taxpayer's IFQs are extractors of natural resources in Alaskan waters, but as a seller of IFQs, the Taxpayer is not extracting any natural resources. Thus, under Rule 135(2) the Taxpayer is not an extractor as it is not taking a natural resource.

RCW 82.04.2907 establishes a special B&O rate of 0.484 percent on gross income from royalties. For purposes of this statute, "gross income from royalties" means compensation for the *use* of intangible property, but does not include "compensation for any natural resource." RCW 82.04.2907(2). As just noted above, the Taxpayer is not taking any natural resources; it is *selling* (not using) IFQs. Contrary to Taxpayer's assertion, nothing in RCW 82.04.2907 requires that we source the sale of an IFQ by a Washington resident out of state.

Finally, we consider taxpayer's reliance on WAC 458-61-520,[3] later promulgated as WAC 458-61A-112 (mining rights and mining claims). In Det. No. 00-154ER, 21 WTD 298 (2002), we discussed the former WAC 458-61-520 and stated/held:

> To the extent a mineral lease transfers ownership of minerals prior to severance it is subject to real estate excise tax (REET). WAC 458-61-520. Conversely, under WAC 458-61-520(3), a mineral lease that does not transfer ownership of the minerals prior to severance from the real property is not subject to REET.

For mineral leases that transfer ownership prior to extraction of the natural resource, real estate excise tax (REET) is due. REET is a tax on the sale of real estate in Washington. WAC 458-61A-100. There is no situation where the sale of the right to fish or even the actual extraction of fish would be considered a sale real property. Because REET is only imposed on real property located in this state, the REET regulations are not analogous to the sourcing rules for intangible property that may be allocated or apportioned to different taxing jurisdictions.

An individual fishing quota (IFQ) is a permit held for exclusive use by a person. . . . As such, it is an intangible right. *Id.* In Washington, there are two different tax treatments of IFQs depending on whether they are leased or sold. Income from the outright sale of an IFQ is considered a sale of an intangible asset under the RCW 82.04.290 service and other activities classification. Taxpayer does not challenge this classification. Income from the use or lease of royalties is subject to the lower B&O rate allowed by RCW 82.04.2907.

Historically, the Washington State has sourced the sale of intangibles to the domicile under the doctrine of *mobilia sequuntur personam* (i.e., movables follow the person). Det. No. 99-063, 24 WTD 1 (2005) This doctrine has been used to create a fictional situs of such property in the domicile of the owner. *Id*. This state has relied on the doctrine in various contexts. *Id*. (Citing *Granite Equipment Leasing Corp. v. Hutton*, 84 Wn.2d 320, 325 (1974), and *O'Keefe v. Dep't of Revenue*, 79 Wn.2d 633, 635 (1971)). By analogy to the case law, the Department has held that, for B&O tax purposes, intangible rights follow the situs of the commercial domicile of the owner. *Id*. (Citing Det. No. 88-233, 6 WTD 59 (1988)).

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[3] WAC 458-61-520 was repealed by 05-23-093, filed 11/16/05, effective 12/17/05. Relevant portions of former WAC 458-61-520 read as follows:

(1) The real estate excise tax applies to the sale of mineral rights in private property. "Mining property" is property containing or believed to contain metallic or nonmetallic minerals and sold or leased under terms which require the grantee or lessee to conduct exploration or mining work thereon and for no other use. (RCW82.45.035) . . .

(3) A mining lease which grants the lessee the right to conduct mining exploration upon or under the surface of real property and to remove minerals from the property in exchange for a royalty is not subject to the real estate excise tax when the lease does not transfer ownership of the minerals to the lessee prior to severance from the real property.

(4) Patented mining claims are real property and their sale is subject to the real estate excise tax.

(5) Unpatented mining claims are intangible personal property and therefore not subject to the real estate excise tax.

For example, in Det. No. 99-023, 19 WTD 340, the taxpayer argued that 1099 income that she received from the sale of her right to receive payment from commissions generated by sub-distributors should be exempt from Washington B&O tax because it was related to services performed in Nevada. In response, we held the following:

> 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.

Under this principle it has been noted:

> . . . royalties and other payments for the use of . . . 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 acquired a business situs in another State, in which event the receipts were allocated to that State. [Footnotes omitted.]

Hellerstein & Hellerstein, State Taxation § 9.09 (2nd ed. 1993) (Underlining added).

See also Det. No. 99-063, 24 WTD 1 (2005) (Tax upheld on royalties for actions previously performed out of state, but where the Taxpayer resided in Washington when the royalties were received.) and 92-004, 11 WTD 551 (1992) two author's royalty income was properly taxed in Washington where they lived. (Taxpayer was a closely held corporation, and some promotional activities were performed outside of Washington.)

6 WTD 59, cited above, which discussed the *mobilia sequuntur personam* doctrine followed in Washington, was a case involving payments on a patent right developed in Washington. However, the payments were sent to the Taxpayer's corporate headquarters outside of Washington, its commercial domicile, and were not properly taxed in Washington. Here, [Taxpayer's] domicile during the audit period was in Washington.

The Taxpayer notes that several of the actions relating to his IFQ sales occurred outside of Washington State. Some of these actions include the buyer being from outside Washington, and some of the sale documents being executed in Alaska, or a state other than Washington. As described in the case law described above, it is the Taxpayer's domicile that is relevant, not whether matters related to the intangible right occurred outside the state.

We conclude the sale of intangibles in this case, the IFQs, should be treated the same as the sale of any other intangibles that we have consistently sourced to the domicile of the owner in the

determinations cited above.[4] If the owner moves, the right moves, and with it the taxability of the payments. Consequently, royalty income received by persons commercially domiciled in Washington follows the person to this state and is taxable.[5]

In conclusion, we hold that the Audit Division correctly sourced the sale of Taxpayer's IFQs to the domicile of the owner in Washington.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 1st day of August 2012.

[4] Effective June 1, 2010, the new economic nexus standard makes income received from the sale of an IFQ attributable to the state where the customer receives the benefit of the service. (Alaska) WAC 458-20-19403(2-1)(a).

[5] We note that effective June 1, 2010, section 105, chapter 23, Laws of 2010 1st sp. sess. changed Washington's method of apportioning gross income from royalties. *See also* WAC 458-20-19403.