

Cite as Det. No. 11-0347, 33 WTD 195 (2014)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

|   |   |                                  |
|---|---|----------------------------------|
| In the Matter of the Petition for Refund of | ) | <u>D E T E R M I N A T I O N</u> |
|   | ) |                                  |
|   | ) | No. 11-0347                      |
|   | ) |                                  |
| ...   | ) | Registration No. . . .           |
|   | ) |                                  |

[1] RCW 82.04.293 B&O TAX – INTERNATIONAL INVESTMENT MANAGEMENT SERVICES. Because a registered investment advisory firm actively managed its clients’ portfolios and had full discretion to buy and sell securities without client approval, its services have the requisite management components that qualify as “investment management services.”

[2] RCW 82.04.293 B&O TAX – INTERNATIONAL INVESTMENT MANAGEMENT SERVICES. Registered investment advisory firm *primarily* provided investment management services because it actively managed client portfolios and had authority to buy and sell securities on its clients’ accounts. The firm met the “primarily” standard because a majority of its services involved those qualifying activities.

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.

Sohng, A.L.J. – Registered investment advisory firm protests the denial of its refund claim and contends that it is entitled to the lower business and occupation (“B&O”) tax rate provided for “international investment management services” under RCW 82.04.290. Taxpayer’s petition is granted in part and remanded in part.<sup>1</sup>

ISSUE

Is a registered investment advisory firm primarily providing “investment management services” under RCW 82.04.293(1)(a)?

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

## FINDINGS OF FACT

[Taxpayer] is located in . . . Washington and is a fee-based, investment advisory firm registered under the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* Taxpayer is not a brokerage firm or a broker-dealer registered under the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* Taxpayer specializes in providing investment services to high net worth individuals and owners of closely held businesses in . . . Washington.

Taxpayer provided a sample Investment Advisory Agreement (the “Agreement”) that it executes with each client. Section 1 of the Agreement, captioned “Investment Advice and Management,” provides as follows:

Client retains [Taxpayer] to manage Client’s Account established as provided in Section 2 with discretion in the investment and reinvestment of the assets thereof, and, subject to such limitations as Client may impose by written notice to [Taxpayer] given in the manner specified by Section 13, grants to [Taxpayer] full power and authority to make such purchases, sales, exchanges, conversions and trades in connection therewith as [Taxpayer] deems appropriate.

Taxpayer represents that 100% of its services consist of investment research (20%), portfolio management (60%), and investment consulting (20%), described in detail as follows:

Investment Research: Taxpayer reviews the securities that it invests for its clients and monitors their performance on an ongoing basis. The securities include, without limitation, stocks, bonds, exchange-traded funds (“ETF”), certificates of deposits, annuities, mutual funds, and partnership interests for domestic, developed foreign and emerging market companies. The investment research includes various aspects of the company, industry, or country. If the security is an ETF, annuity, or mutual fund, Taxpayer performs further research, comparing it to the applicable index to track performance, risk, volatility, and expenses, as well as monitoring the fund or the annuity company itself.

Portfolio Management: Taxpayer actively manages its clients’ portfolios and has full discretion to buy and sell securities without client approval or involvement. Portfolio management involves implementing clients’ initial investment plans by buying and selling securities that are executed by a third-party custodian. Taxpayer also manages cash balances; invests new deposits, interest, or dividends; sells funds if a distribution is needed; and rebalances portfolio assets as needed. Taxpayer also provides performance reporting and other reports regarding investments to its clients.

Investment Consulting: Taxpayer’s investment consulting services consist of analyzing its clients’ current holdings and asset allocations, recommending new asset allocations (if necessary), and making other recommendations with respect to the clients’ holdings, depending on the client’s unique financial position.

On December 21, 2010, Taxpayer applied for a refund of taxes paid for the period December 2005 through December 2010 on the grounds that it should have been taxed under the business and occupation tax classification for “international investment management services” provided in RCW 82.04.290. On March 2, 2011, the Taxpayer Account Administration Division (“TAA”) denied Taxpayer’s refund application, stating that Taxpayer “primarily provides financial and investment services and is not an international investment manager under RCW 82.04.293.” On March 23, 2011, Taxpayer timely appealed the denial of its refund claim. In its response to Taxpayer’s appeal petition, TAA argued that Taxpayer “provides financial advisory services which may include international investments. However, [Taxpayer] does not provide investment management services and therefore does not qualify to report their income under international investment manager at a lower B&O rate of 0.0275<sup>2</sup> percent per RCW 82.304.290 and 82.04.293.”

#### ANALYSIS

RCW 82.04.290(1) provides a special B&O tax classification for persons who provide international investment management services (“IIMS”). A taxpayer provides IIMS if it meets the two-part test set out in RCW 82.04.293(1). That section provides:

- (1) A person is engaged in the business of providing international investment management services, if:
  - (a) Such person is engaged primarily in the business of providing investment management services; and
  - (b) At least ten percent of the gross income of such person is derived from providing investment management services to any of the following: (i) Persons or collective investment funds residing outside the United States; or (ii) persons or collective investment funds with at least ten percent of their investments located outside the United States.

“Investment management services” is defined as “investment research, investment consulting, portfolio management, fund administration, fund distribution, investment transactions, or related investment services.” RCW 82.04.293(2). The terms within this definition are not further defined by statute or administrative rule. In ascertaining the meaning of a particular word used in a statute, the court must consider “both the statute’s subject matter and the context in which the word is used.” *Port of Seattle v. Dep’t of Revenue*, 101 Wn. App. 106, 112, 1 P.3d 607, 610 (2000). The language of a statute must be read in context with the entire statute and construed in a manner consistent with the general purpose of the statute. *See, e.g., Graham v. State Bar Ass’n*, 86 Wn.2d 624, 627, 548 P.2d 310 (1976). In general, references to commercial terms should be given the meaning commonly used in the regulated industry, absent clear legislative intent to the contrary. *See City of Spokane, ex rel. Wastewater Mgmt. Dep’t v. Dep’t of Revenue*, 145 Wn.2d 445, 452, 38 P.3d 1010 (2002); NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION § 47:31, at 366-67 (6th ed. 2000). Technical words, or terms of art relating to trade, when used in the statute dealing with the subject matter of such trade, are to be taken in their technical

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<sup>2</sup> TAA inadvertently stated a rate of .0275%. The correct rate is .275%.

sense. 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION, § 47:29, at 260 (5<sup>th</sup> ed. 1992).

Because the activity at issue here is “investment *management* services,” we interpret this definition to require some management component in each of the enumerated services Taxpayer provides. For example, a broker-dealer transaction may incidentally involve investment research or investment consulting, but such transactions are not considered “investment management services” because they lack the requisite management component. [Because Taxpayer actively manages its clients’ portfolios and has full discretion to buy and sell securities without client approval or involvement,] [w]e conclude that Taxpayer’s performance of portfolio management, investment research, and investment consulting, as described above, has the requisite management component and therefore qualifies as “investment management services.”

Next, we must determine whether Taxpayer *primarily* provides “investment management services.” TAA claims that Taxpayer does not primarily provide “investment management services” on the grounds that management of client assets is ancillary to other services. The word “primarily” is not defined in the statute. When statutory terms are not defined, the Department may look to the dictionary meaning for guidance. *See Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 609, 998 P.2d 884 (2000); *Garrison v. Wash. State Nursing Bd.*, 87 Wn.2d 195, 196, 550 P.2d 7 (1976). “Primarily” means “first of all, fundamentally principally.” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE 1800 (1993).

. . . Taxpayer . . . actively manages client portfolios and has authority to buy and sell securities on its clients’ accounts. . . . Accordingly we conclude that Taxpayer’s business primarily consists of investment research, portfolio management, and investment consulting, all of which are considered “investment management services” under RCW 82.04.293(2).<sup>3</sup> As a result, Taxpayer meets the first prong of the two part test provided in RCW 82.04.293(1)(a). [Because, on these facts, we find that a majority of the Taxpayer’s services involved qualifying activities,] Taxpayer’s petition is granted in part [subject to verification that Taxpayer’s services are as represented].

#### DECISION AND DISPOSITION

Taxpayer petition is granted in part and remanded in part. We are remanding the case to the Taxpayer Account Administration Division to determine if Taxpayer meets the second part of the two part test provided in RCW 82.04.293(1)(b), for possible adjustment to the assessment . . .

Dated this 6th day of December 2011.

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<sup>3</sup> On February 28, 2014, the Department of Revenue issued Excise Tax Advisory 3183.2014 (ETA 3183.2014) which clarifies the requirements for a taxpayer seeking to qualify for the international investment management services B&O tax rate. [Under this ETA, “primarily” means “more than 50%.”]