

Cite as Det. No. 15-0277, 35 WTD 246 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 15-0277
)	
...)	Registration No. . . .
)	

RULE 164; RCW 47.17.010; RCW 82.04.260; RCW 82.04.290: B&O TAX – CLASSIFICATION – INSURANCE AGENTS/PRODUCERS – SERVICE AND OTHER ACTIVITIES – MARKETING. A licensed insurance producer that provided marketing services for an insurer, and was not selling, soliciting, or negotiating insurance on the insurer’s behalf, was subject to B&O tax under the service and other activities classification.

RCW 82.04.080; RCW 82.04.460; RCW 82.04.462: B&O TAX – GROSS INCOME – DEDUCTION – TRANSFER PRICING – AFFILIATE. The taxpayer’s transfer pricing payments to an affiliate were not deductible from its gross income used to measure its B&O tax.

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.

M. Pree, A.L.J. – An out-of-state company that provided marketing services for a Washington insurance company, protests additional business and occupation (B&O) taxes assessed under the service and other activities classification when its deduction for marketing materials was disallowed. The company contends that its income should be taxed under the lower B&O tax rate for the activities of insurance producers or agents. Because the company provided marketing services for the insurer, rather than insurance services for the policy holders, its income was properly taxed under the service and other activities B&O tax classification. In the alternative, the company seeks to deduct payments to a foreign affiliate, under a transfer pricing agreement (TPA). We deny the petition.¹

ISSUES

1. For B&O tax purposes, was the company’s insurance marketing income classified under RCW 82.04.260 as an insurance agent/broker, or classified under RCW 82.04.290 for service and other activities?

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

2. Under RCW 82.04.080, could the company deduct payments to a foreign affiliate, under a TPA that it had with that affiliate?

FINDINGS OF FACT

[Taxpayer] is an out-of-state corporation, licensed with the Washington State Office of the Insurance Commissioner (OIC) as an insurance producer. The taxpayer entered marketing assistance agreements (MAA) with Washington insurers to support sales of insurers' products in Washington. The taxpayer sent the insurers' policy holders materials soliciting additional insurance products. The insurers paid the taxpayer a commission based upon new premiums paid by the policy holders for the additional products. The taxpayer did not pay insurance premium taxes on the commissions.

In 2006, the taxpayer wrote the Department of Revenue (Department) regarding whether its Washington direct marketing activities were subject to Washington excise taxes. The Department's Taxpayer Information and Education Section (TI&E) of its Taxpayer Services Division instructed the taxpayer to file excise tax returns and pay apportioned B&O taxes under the service and other activities classification. The taxpayer filed returns for the 2nd and 3rd Quarters of 2010 reporting the commission income and claimed "other" deductions for the marketing expenses that it paid.

In 2014, the Department's Taxpayer Account Administration Division (TAA) examined the taxpayer's returns and activities for the period from April 1, 2010 through December 31, 2010 (audit period). TAA disallowed the taxpayer's deductions, and on October 28, 2014, issued Document Number Document Number . . . assessed \$. . . in B&O tax under the service and other activities classification, \$. . . and \$. . . in interest, and a \$. . . five percent assessment penalty. With a \$. . . credit for a 2014 payment, the assessment totaled \$ The taxpayer appealed.

During the examination, the taxpayer wrote TI&E again, this time requesting that it be classified as an Insurance Agent/Broker for B&O tax purposes. Noting that the taxpayer was a licensed insurance producer, TI&E agreed with the taxpayer. On December 30, 2014, after the assessment above was issued, TI&E instructed the taxpayer that its gross income was subject to B&O tax under the Insurance Producers/Title Insurance Agents; Surplus Line Brokers Commissions classification. The taxpayer requests that the Department recompute its tax liability at the lower rate under the Insurance Producers/Title Insurance Agents; Surplus Line Brokers Commissions classification.

The taxpayer explains that, in 2010, it agreed to target existing policy holders of a Washington insurer² for accidental death coverage provided by the insurer. After the insurer provided the taxpayer a list of the policy holders, the taxpayer analyzed and refined the list, then prepared customized direct mail packages for specific policy holders. The taxpayer incurred and paid the marketing costs.

² The taxpayer states that through an administrative oversight, that Washington insurer, . . . , was not listed as an insurance provider on its filing with the Washington State Office of the Insurance Commissioner (OIC).

The mailing did not name the taxpayer, only the insurer, whose president signed the cover letter. Similarly, only the insurer's name appeared on both the envelope's return address, and the enclosed business reply envelope. Policy holders were asked to sign an authorization form to pay an additional premium for an additional benefit (in this case, accidental death coverage). A toll free number was provided. The taxpayer explains that it paid a third party to process the returned authorization forms. The taxpayer has not provided any evidence that the policy holders had any knowledge that they were dealing with anyone other than the insurer when agreeing with insurer to pay additional premiums to obtain their accidental death benefit.

Finally, in the alternative, the taxpayer argues that if its income is not taxed under the Insurance Producers/Title Insurance Agents; Surplus Line Brokers Commissions B&O tax classification, it should be allowed to deduct payments it made to a foreign affiliate, . . . (affiliate), under a TPA it had with the affiliate. While the affiliate was named in the contract with the insurer, it did not sign the contract. Under the terms of the TPA, the taxpayer is not an authorized representative, partner, or agent of the affiliate. The TPA states that the affiliate provides services to insurers, “. . . in developing and administering programmes for the marketing of the Approved Underlying Policies and engages its affiliated business units ('Business Units') around the world to provide assistance to [affiliate] in that respect.” We understand that the affiliate oversees the taxpayer's activities and performs administrative functions.

ANALYSIS

Washington imposes the B&O tax on the privilege of engaging in business in this state. RCW 82.04.220. Depending on the nature of the business activity being conducted, the tax is levied upon the value of products, the gross proceeds of sales, or the gross income of the business. *Id.* The tax rate also depends on the nature of the business activity being conducted. Business activities other than or in addition to those that are specifically enumerated elsewhere in Chapter 82.04 RCW, or RCW 82.04.290(1) or (3), are taxed under the service and other activities B&O tax classification at a rate of 1.5 percent of their gross income. RCW 82.04.290(2). “Gross income of the business” means:

. . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services, . . . commissions, . . . all without any deduction . . . or any other expense whatsoever paid or accrued . . .

RCW 82.04.080. RCW 82.04.260(9) provides for a special B&O tax classification with a lower rate for the activities of insurance producers or agents:

Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

RCW 48.17.010(5) defines an “insurance producer” as, “. . . a person required to be licensed under the laws of this state to sell, solicit, or negotiate insurance.” *See also* WAC 458-20-164

(Rule 164). Under Rule 164(3) persons engaged in business as insurance producers are taxable under the insurance producers B&O tax classification on commissions and fees “on gross income earned from such licensed activities.” From the information provided,³ the gross income from taxpayer’s activities are not “from such licensed activities,” but derived from developing and administering marketing plans. While the taxpayer is a licensed insurance producer, based on the information provided regarding the services it performs for the income from the insurer, we consider it to be providing marketing services for the insurer, not selling, soliciting, or negotiating insurance on the insurer’s behalf. Marketing services are subject to B&O tax under the service and other activities classification in RCW 82.04.290 while insurance producers are classified under RCW 82.04.260(9). Persons engaged in activities that are subject to tax under two or more provisions of RCW 82.04.230 through 82.04.298, inclusive, are taxable under each provision applicable to those activities. *See* RCW 82.04.440.

While we recognize that the taxpayer is licensed under the laws of Washington to sell, solicit, or negotiate insurance, there is no evidence that it performed those activities during the audit period. It did not perform those activities for the insurer, the only contract of which we are aware for the audit period. From the materials submitted, policy holders would believe that they are only dealing with the insurer, not someone else selling, soliciting, or negotiating their insurance. Even the filings with the OIC during the audit period do not list the taxpayer as an insurance producer for the insurer.

The taxpayer provides analysis, marketing, and mailing services for the insurer. The policy holders are unaware of the taxpayer. The insurer uses the taxpayer’s services to best market its policies, not to deal with the policy holders on its behalf or to provide insurance to the policy holders. Under the facts before us, the taxpayer’s activities at issue are not those of an insurance producer linking the policy holders to the insurer, but are marketing services, which include analysis and mailings for the insurer, and allow the insurer (not the taxpayer) to solicit additional business from its policy holders. These activities are not “with respect to such licensed activities,” contemplated by RCW 82.04.260(9). As such, we conclude that TAA appropriately assessed B&O tax under the service and other activities classification.

Under RCW 82.04.080(1), no deductions are allowed to arrive at gross income:

"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, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

Transfer pricing is a method used by controlled corporations to shift profits whereby affiliates charge each other for goods and services. *See* Treas. Reg. Section §1.482-7. The charges for

³ The taxpayer only provided information (letters, forms, contracts) for . . . , for whom the taxpayer was not shown as an insurance producer on the OIC website.

these goods and services are gross income for one entity, and deducted as costs of goods sold or expenses for the affiliate to arrive at taxable income to compute income tax. *Id.* To prevent affiliates from shifting their profits from jurisdictions with high income tax rates to those with low tax rates, the Internal Revenue Service, taxing authorities in other countries, and the revenue departments of income tax states have adopted regulations that are intended to ensure that transactions between related subsidiaries occur at market prices. *See Id.*

. . . Washington does not have an income tax, but subjects gross receipts and gross income to B&O tax without deducting costs of goods sold or business expenses paid to an affiliate. . . . There is no specific authority under Washington Excise Tax Law (Title 82 RCW), which allows a transfer pricing deduction. RCW 82.04.080 specifically provides that to determine gross income there is no deduction for costs of goods sold or other expenses. TAA properly denied the deduction.

While the taxpayer's costs (including any transfer pricing payments to its affiliate) are not deductible to determine its gross income under RCW 82.04.080, its income may be apportionable under RCW 82.04.460. *See also* RCW 82.04.462 effective June 1, 2010. RCW 82.04.460 was amended effective June 1, 2010, and the method of apportionment changed during the audit period. However, that issue is not before us and we affirm the assessment based on the records provided.

DECISION AND DISPOSITION

We deny the taxpayer's petition.

Dated this 20th day of October, 2015.