

Cite as Det. No. 15-0352, 36 WTD 179 (2017)

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. 15-0352
)	
... )	Registration No. . . .
)	

[1] Rule 19402; RCW 82.04.460 and RCW 82.04.462; APPORTIONMENT – BENEFIT OF SERVICE. Out-of-state provider of investment advice and management services was subject to B&O tax and a portion of its income properly attributed to Washington where taxpayer’s sole customer was an out-of-state mutual funds manager with individual investors located in Washington.

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.

Valentine, A.L.J. – An out-of-state taxpayer providing mutual fund investment management services appeals the assessment of business and occupation (B&O) tax, under the service and other business activities (Service) classification, on income the Department of Revenue (Department) [attributed] to Washington. The taxpayer contends none of its income should be [attributed] to Washington because its sole customer, a financial services company, receives the benefit of the taxpayer’s services [out-of-state], where the customer is located. The taxpayer’s petition is denied. We conclude that the individual investors in the mutual funds managed by the taxpayer are the ultimate benefit recipients of the taxpayer’s investment management services. . . .<sup>1</sup>

ISSUES

1. Pursuant to RCW 82.04.460, RCW 82.04.462, and WAC 458-20-19402 (Rule 19402), did the Department properly [attribute] a portion of a taxpayer’s income to Washington when the taxpayer, a mutual fund advisor, has one customer and that customer is located in another state?

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FINDINGS OF FACT

[Taxpayer] is an out-of-state company that provides investment advisory and management services. Taxpayer has one customer, . . . (Customer). Customer is domiciled and headquartered [out-of-state].

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

In an email to the Department, dated April 19, 2011, Taxpayer provided the following description of its business:

[Taxpayer] is the Advisor for [Funds] shares and handles the general management of the portfolios. [Taxpayer] provides general management services to the [Funds], including overall supervisory responsibility for the general management of each [Fund's] securities portfolio.

The Department's out-of-state Audit Division (Audit) reviewed Taxpayer's business activities for the time-period of June 1, 2010, through December 31, 2012 (audit period). Audit's review was limited in scope to a review of Taxpayer's gross income.

Taxpayer came to the Department's attention because it submitted a Washington Amnesty Application on April 15, 2011. On April 21, 2011, Taxpayer submitted correspondence to the Department withdrawing its application. Taxpayer's correspondence reads, in pertinent part:

We filed our amnesty application on April 15, 2011, just prior to the deadline. In order to file a valid amnesty application, we had to estimate tax due. We entered a deminimis amount prior to actually knowing exactly what our tax liability would be in order to meet the filing deadline. Once we filed the amnesty application, we received the Washington Business Activities Questionnaire, a form designed to explain all of our Washington activities. We had to determine our business activities accurately to complete this required form. Upon further review, we found that [we perform] advisory services. These services include general management services and investment of our securities. The services are performed and the income is earned [out-of-state].

Attached please find our completed business activities questionnaire. Our responses indicate that we do not have business in Washington. Based on our review of the business, we now believe that we do not meet the nexus requirements for filing Washington business and occupation tax returns. We ask that you accept this business activities questionnaire. We respectfully request that you amend your records to show that this company has no Washington filing requirements.

Audit's position is that the individual investors in the mutual funds are receiving the benefit of Taxpayer's services; thus, Taxpayer's income generated from Washington investors should be attributed to Washington as taxable income. Audit estimated that Taxpayer's income [attributed] to Washington equaled five percent of Taxpayer's total income for the audit period.<sup>2</sup>

#### ANALYSIS

1. Did the Department properly [attribute] a portion of a taxpayer's income to Washington when the taxpayer, a mutual fund advisor, has one customer and that customer is located in another state?

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<sup>2</sup> Taxpayer did not provide records so Audit used an estimate.

The primary issue in dispute here is whether any of Taxpayer's apportionable income is attributable to Washington for the audit period.

"Apportionable income" is gross income of the business generated from engaging in apportionable activities. RCW 82.04.460(4)(a). "Apportionable activities" specifically include those taxed under RCW 82.04.290 (Tax on international investment management services or other business or service activities.). RCW 82.04.460(4)(a)(vi).

Effective June 1, 2010, RCW 82.04.460(1) provides:

Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

Income apportioned to Washington is multiplied by a "receipts factor," the numerator of which is the gross income of the business attributed to Washington and the denominator of which is the gross income of the business worldwide. RCW 82.04.462(1), (3)(a).

RCW 82.04.462 provides a series of cascading rules for purposes of determining to which state a taxpayer's gross income is attributable. RCW 82.04.462(3)(b) provides, in pertinent part:

. . . [F]or purposes of computing the receipts factor, gross income of the business generated from each apportionable activity is attributable to the state:

- (i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property.

Rule 19402 is the Department's rule that explains "the apportionment of income from engaging in apportionable activities." Section 304 of Rule 19402 provides examples "of the application of the benefit of service analysis and reasonable methods of proportionally attributing receipts." Example 32 is applicable to the facts of this case. It reads:

Investment Manager manages a mutual fund. Investment manager receives a fee for managing the fund based on the value of the assets in the fund on particular days. Investment Manager knows or should know the identity of the investors in the fund and their mailing addresses. The fees received by Investment Manager (whether from the mutual fund or from individual investor's accounts) are for services provided to the investors. Investment Manager's services do not relate to real or tangible personal property and do not require that the client be physically present, therefore, the benefit of Investment Manager's services is received where the investors are located and Investment Manager's apportionable receipts must be attributed to those locations.

Consistent with Example 32, the customers receiving the benefit of Taxpayer's services are the individual investors purchasing the investment products. Thus, income should be attributed based on the locations of the individual investors and not the billing address of the company selling the investment product. Taxpayer's petition is denied on this issue.

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#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 22nd day of December 2015.