

Cite as Det. No. 13-0254, 36 WTD 265 (2017)

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. 13-0254
)	
...)	Registration No. . . .
)	

RULE 108; RCW 82.04.080, RCW 82.04.220: B&O TAX – GROSS INCOME – “CASH BACK” MANUFACTURER INCENTIVES. When an automobile dealer performs services in exchange for manufacturer “cash back” incentives, the incentive payments received are subject to 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. – A Washington automobile dealer protests business and occupation (B&O) tax assessed on incentives paid by a car manufacturer. Because the dealer performs services for the incentives, the dealer owes B&O tax on the payments.¹

ISSUE

Under RCW 82.04.080, RCW 82.04.220, and WAC 458-20-108, does an automobile dealer’s taxable gross income include automobile manufacturer incentives paid to the dealer for services?

FINDINGS OF FACT

[Taxpayer] operates a car dealership in Washington from which it sells and leases new and used cars. It also sells commercial vehicles, parts, other vehicle products, extended warranties, and services, including repairs. The taxpayer has a franchise agreement with [Car Manufacturer]. [Car Manufacturer] pays the taxpayer bonuses or incentives. The taxpayer did not pay B&O tax on the incentives. Rather, the taxpayer subtracted the incentives from its costs of the automobiles sold in computing its gross profit.

The Department of Revenue (Department) audited the taxpayer’s records for the period of January 1, 2007, through March 31, 2011, with the objective of verifying that the taxpayer’s Washington

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

State business activities and transactions were properly reported on its excise tax returns.² The Audit Division assessed B&O tax on eight incentive accounts under the service & other activities classification.

The taxpayer contends that these incentive payments should not be taxable because they were discounts for its wholesale vehicle purchases. According to the taxpayer, the dealership already had to comply with the requirements for the disputed incentives in order to comply with its franchise agreement with [Car Manufacturer], and the purchases would occur as a course of business, whether or not an incentive existed or not. The taxpayer notes that in 1999, [Car Manufacturer] implemented a new marketing plan that substantially increased dealers' wholesale costs relative to [Car Manufacturer's] recommended retail sales prices. To offset the dealers' decreased profit margins, the taxpayer states [Car Manufacturer] increased and offered new dealer cash incentives.

The Audit Division reviewed the franchise agreement to see if it specified all of the same requirements for which the taxpayer received incentive payments. The taxpayer stated that the franchise agreement was not so specific, and would not have the same specific requirements as the incentive programs. The Audit Division did not assess tax on all incentives. The Audit Division assessed tax on the incentives that appeared to have additional requirements, beyond those of the franchise agreement. As such, the Audit Division concluded that the incentive programs required the rendition of additional activities to receive the compensation.

Workpaper B lists eight accounts in dispute upon which the Audit Division assessed B&O tax under the service & other activities tax classification.³ These accounts are These accounts are similar in that the credits from [Car Manufacturer] were percentages⁴ of the value of the vehicles sold from [Car Manufacturer] to the taxpayer.

Account . . . represented the customer loyalty bonus. To receive the customer loyalty payment, the taxpayer had to meet specific requirements. These requirements included investment in BDC/CRM solution project blueprint compliance,⁵ enrollment in the Dealer Customer Journey Program, along with other marketing communication guidelines and standards compliance.

Account . . . was labeled, "Performance Bonus," and paid if the taxpayer met certain e-mail marketing and training requirements. Similarly, account . . . labeled the "Retail Compliance Bonus," later became part of the Performance Bonus. The same requirements to receive the Performance Bonus were required to receive this bonus.

² The audit was qualified to the extent that the Department reserved the right to verify any other liability within the statute of limitations period.

³ There are several accounts that the Audit Division considered non-taxable because there was no consideration to receive payment. These accounts were Accounts . . . were volume discounts, which were specifically exempted from tax. Account . . . was for payments received from holdbacks, which was specifically exempted from sales. The last account . . . was not as clear. It required the dealership to meet certain customer satisfaction standards, as conducted through surveys of customers by [Car Manufacturer]. The Audit Division determined that account . . . was non-taxable because it did not require any action by the taxpayer.

⁴ The . . . bonus (account . . .) was a flat \$. . . per vehicle sold by the taxpayer during a specific period.

⁵ From the internet, this appears to be software used to improve customer service. See http://www.bdc.ca/EN/solutions/smart_tech/tech_advice/free_low_cost_applications/Pages/crm_applications.aspx.

Account . . . , labeled, “Brand Standards Bonus” required that the taxpayer maintain its facilities at a certain level. To receive the Brand Standards Bonus, the taxpayer had to purchase specific furnishings and signage and have specific décor for the exterior and interior of the building. Formerly this was account . . . , labeled, “CRI Bonus,” which became the Brand Standards Bonus. The same requirements to receive the Brand Standards Bonus were required to receive the CRI bonus. Similarly, to receive the . . . bonus (Account . . .), the taxpayer had to meet certain facility design and specifications.

Account . . . was labeled, “Pre-Owner Premier/CPO Bonus,” which required the taxpayer to acquire minimum percentages of specific classes of used vehicles. Account . . . , labeled, “Commercial Vehicle Bonus,” required the taxpayer to meet certain training, compliance, and facility standards. While the Audit Division found that some of the incentives qualified as discounts, which were not taxed, it assessed B&O tax on the eight incentive accounts identified above because to receive each incentive, the taxpayer was required to perform additional activities.

ANALYSIS

Washington’s B&O tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” *Analytical Methods, Inc. v. Dep’t. of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996), quoting *Palmer v. Dep’t. of Revenue* 82. Wn. App. 367, 371, 917 P.2d 1120 (1996). For purposes of the B&O tax, “business” is broadly defined to include “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.” RCW 82.04.140. RCW 82.04.220, in turn, imposes the B&O tax on persons engaged in business. It provides:

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

“Gross income of the business” is broadly defined by RCW 82.04.080 as:

. . . 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.

The taxpayer contends that its incentives were bona fide discounts, not includible in its gross income.⁶ WAC 458-20-108 (Rule 108) authorizes a deduction from gross proceeds of sales for

⁶ Dealers need not provide services to their manufacturers in order for the manufacturers’ payments to the dealers to be gross income. Providing a service is a sufficient, but not a necessary, condition for taxation. If services were not provided, the payments should fall within the “other emolument” clause of RCW 82.04.080 unless the dealers contemplated the payments when they purchased the vehicles from the manufacturers, similar to the “holdback” and

bona fide discounts actually taken by the buyer. Rather than simply discount the wholesale purchase price of the vehicles, in 1999, [Car Manufacturer] increased its wholesale prices relative to the dealers' retail sales prices and offered the cash incentives to give the dealers an opportunity to restore their profit margins. [Car Manufacturer] was not obligated to pay the cash incentives at issue when the taxpayer purchased the vehicles. The Audit Division allowed the taxpayer to exclude the cash incentives where [Car Manufacturer] required no additional services (Accounts . . . and . . . for volume discounts were not taxed, nor were payments in Account . . . from holdbacks similar to those in Det. No. 91-263, 11 WTD 263 (1991), or payments in Account . . . based on customer satisfaction, where no services were required). However, the cash incentives for which [Car Manufacturer] required additional activities are not excluded as bona-fide discounts under Rule 108.

The taxpayer seeks to compress two transactions: [Car Manufacturer's] wholesale sale of vehicles to the taxpayer and the taxpayer's activities to obtain cash incentives. However, the taxpayer and [Car Manufacturer] set up these two transactions. We do not disregard the form of transactions structured by a taxpayer. *See Washington Sav-Mor Oil Co. v. State Tax Comm'n*, 58 Wn.2d 518, 521, 364 P.2d 440 (1961). [Car Manufacturer] structured the cash incentives as payments for specific services.

To receive the loyalty bonus (Account . . .), the taxpayer had to invest in the BDC/CRM project and enroll in the Dealer Customer Journey Program. To receive the performance bonus (account . . .) and the retail compliance bonus (account . . .), the taxpayer had to conduct e-mail marketing and training. The "Brand Standards Bonus" and "CRI Bonus" (Accounts . . . and . . .) required that the taxpayer maintain its facilities at a certain level with a specific décor for the exterior and interior of the building and purchase specific furnishings and signage. The . . . bonus (Account . . .) required the taxpayer to meet certain facility design and specifications. The "Pre-Owner Premier/CPO Bonus" (Account . . .) required the taxpayer to have adequate space available for vehicle display and customer use in addition to displaying the . . . logo. The "Commercial Vehicle Bonus" (Account . . .) required the taxpayer to acquire and maintain commercial vehicle tools, equipment, and inventory, as well as, to train its employees.

None of these pertain to discounting the taxpayer's purchase price of specific vehicles; rather, they entail other activities performed by the taxpayer for which it receives payment from [Car Manufacturer]. They are measured by the MSRP of the taxpayer's vehicle sales. While the taxpayer claims that these activities were required in [Car Manufacturer's] franchise agreement, the franchise agreement was general and did not specify the degree or the precise actions for which [Car Manufacturer] paid the taxpayer a bonus or cash incentive. It required the taxpayer to pay [Car Manufacturer's] prices for the vehicles. While the Audit Division allowed other discounts applied to the taxpayer's purchases, these cash incentives taxed in the assessment did not qualify

other automatic payments the dealers receive shortly after wholesale purchases. [*See Steven Klein, Inc. v. Dep't of Revenue*, 184 Wn. App. 344, 352, 336 P.3d 663 (2014), *affirmed*, 183 Wn.2d 889, 357 P.3d 59 (2015) (manufacturer's payment to dealer did not need to represent compensation for service to be taxable).] In this case, while the Audit Division recognized holdbacks and some other payments were contemplated, and the taxpayer met the conditions to receive them at or near the time it purchased the vehicles, the Audit Division taxed the eight cash incentive accounts because the taxpayer provided services above and beyond those required under the franchise agreement to receive the incentives.

as bona fide discounts under Rule 108. We conclude that under RCW 82.04.080, the taxpayer's gross income included the eight incentives, which were subject to B&O tax under RCW 82.04.220.

In Det. No. 91-263, 11 WTD 263 (1991), we held that funds returned to automobile dealerships under a Dealer Holdback Program (DHP) and Wholesale Floor Plan Protection Program (WFPP) provide a reduction in price and are not subject to taxation based upon Rule 108. In these programs, which are also routinely used in the automobile sales industry, dealers pay surcharges for DHP and WFPP payments when they purchase vehicles and place them into inventory. Most, if not all, of this money is subsequently paid back to the dealer as contemplated by both parties when the original sale was made. We wrote:

When the dealer purchases an automobile from the manufacturer, **both parties are well aware that the 3% holdback will be returned to the dealer** soon after the invoice date. Indeed, whether this be termed a cash discount, a trade discount, or merely a partial refund of purchase price, **it is clearly a revision to the original purchase price** of the automobile that was **contemplated by both parties at the time of the original sale**. Under **these circumstances** the gross proceeds of sale and selling price must be “determined by the transaction as finally completed.”

11 WTD at 263 (emphasis added.)

We do not find the decision in 11 WTD 263 applicable to the disputed cash back incentives; as such, incentives are materially different from holdbacks. In 11 WTD 263, we found that the return of holdbacks constitutes a revision to the original purchase price because this “was contemplated by both parties at the time of the original sale.” *Id.* In that case, this was evidence of intent to treat the transaction as a single transaction.

In our case, the Audit Division recognized the taxpayer's holdbacks and other payments similar to those allowed in 11 WTD 263 as exempt from B&O tax. The Audit Division distinguished cash incentives where [Car Manufacturer] had not made a commitment to the taxpayer until after the purchase, and where the taxpayer was required to perform certain activities.

In 11 WTD 263, the manufacturer was contractually obligated to return holdback money when the dealer purchased the vehicles. *Id.* at 265. With the incentives at issue here, neither the taxpayer, nor [Car Manufacturer] knows whether the taxpayer will meet the incentives when vehicles are purchased. The taxpayer must meet certain requirements to earn the incentives. No such post-sale activity is necessary to activate the manufacturer's obligation to issue credits in the case of holdbacks. [Car Manufacturer] did not holdback money in the eight disputed incentive accounts from the taxpayer in the original wholesales purchase agreements. Therefore, we conclude that the Audit Division properly included those incentives in the taxpayer's gross income under RCW 82.04.080.^[7]

⁷ [See *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 900-01, 357 P.3d 59 (2015) (concluding dealer cash payments were not bona fide discounts on an auto dealer's wholesale purchases from the auto manufacturer where the wholesale purchase was not made subject to the dealer cash payment, in contrast to holdbacks and other similar credits).]

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 15th day of September 2013.