

Cite as Det. No. 15-0155, 35 WTD 406 (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. 15-0155
)	
...)	Registration No. ...
)	

[1] RULE 194; RCW 82.04.460: B&O TAX – APPORTIONMENT – SPONSORSHIP REVENUE – CONFERENCES. Prior to June 1, 2010, the taxable activity giving rise to out-of-state conference sponsorship income was the holding of out-of-state conferences and separate accounting is appropriate. Because the conference sponsorship income received can be specifically assigned outside of Washington, the taxpayer’s sponsorship income is to be apportioned entirely outside of Washington.

[2] RULE 19402; RCW 82.04.460; RCW 82.04.462: B&O TAX – APPORTIONMENT – SPONSORSHIP REVENUE – CONFERENCES – REASONABLE METHOD OF PROPORTIONALLY ATTRIBUTING RECEIPTS. After June 1, 2010, sponsorship revenue is to be proportionally attributed. There are benefits to sponsoring a conference when national conference attendees come from all over the country, like brand awareness and product advertising, that can be attributed to locations other than the place where the conference is held. Therefore, apportionable sponsorship receipts must be attributed proportionally and reasonably.

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.

Weaver, A.L.J. (as successor to Munger, A.L.J.) – An out-of-state computer software corporation petitions for correction of an assessment, claiming that the sponsorship revenue it received for holding software conferences outside of Washington is not taxable in Washington. The company also seeks a credit for collected and unremitted sales taxes that it claims it refunded to its customers and a waiver of the 5% assessment penalty. Taxpayer’s petition is granted with respect to the convention sponsorship revenue, but denied on all other issues. The matter is remanded to the Audit Division for adjustments consistent with this determination.¹

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

ISSUES

1. Whether, under RCW 82.04.460, for periods prior to June 1, 2010, a taxpayer's sponsorship revenue for conventions held outside of Washington is taxable in Washington.
2. Whether, under RCW 82.04.462 and WAC 458-20-19402, for periods after June 1, 2010, a taxpayer's sponsorship revenue for conventions held outside of Washington should be attributed to the convention location.
3. Whether, under RCW 82.08.050 and WAC 458-20-217, a taxpayer is entitled to an adjustment of collected and unremitted sales taxes by providing credit memos when those credit memos do not show that retail sales tax charged on a previous invoice was refunded to the taxpayer's customers.
4. Whether, under RCW 82.32.105 and WAC 458-20-228, a taxpayer is entitled to a waiver of the substantial underpayment penalty.

FINDINGS OF FACT

[Taxpayer], an out-of-state corporation, was a business engaged in computer software sales, licensing, and consultation. Taxpayer's business was purchased and it closed its account with the Department on December 31, 2013. Taxpayer's products and services were primarily marketed to manufacturing and warehouse management industries. Taxpayer had non-resident employees who entered Washington to solicit sales and consult with Taxpayer's Washington customers. The Audit Division of the Department of Revenue (Department) examined Taxpayer's excise tax returns for the period of January 1, 2009 through December 31, 2012.

In March, 2013, Taxpayer provided the Department's Audit Division with invoices for the audit period of January 1, [2009] through December 31, 2012, as well as a summary worksheet. The Audit Division made adjustments based [on] classification errors discovered in the examination. During the examination, the Audit Division concluded that proceeds from retail sales were incorrectly reported under the wholesaling business and occupation (B&O) tax classification. The Audit Division also found errors in Taxpayer's service & other activities B&O tax reporting. Taxpayer's service-taxable revenue was either not reported or was misclassified as either retailing or wholesaling.

The Audit Division used invoices received from Taxpayer in order to determine the reclassification of income. The Audit Division did have further questions but had difficulty getting a response from Taxpayer. These questions primarily related to the profit-sharing, sponsorship, and marketing income received from various sources, primarily the [Customer]. Customer's principal place of business is in Washington. The Audit Division classified income from unspecified services under the service & other activities B&O tax classification.

In December, 2013, Taxpayer sent the Audit Division information regarding its sponsorship income. Taxpayer indicated that much of that income was attributable to conferences held outside of Washington. Taxpayer identified certain sponsorship revenue it received from

Customer for its . . . Conferences. In 2009, Taxpayer's Conference was held in [out-of-state]. In 2010, the Conference was held in [out-of-state]. In 2011, the Conference was held in [out-of-state]. In 2012, the Conference was held in [out-of-state].

In 2009, Customer paid Taxpayer \$. . . for its Conference Sponsorship. In 2010, Customer paid Taxpayer \$. . . for its Conference Sponsorship. In 2011, Customer paid Taxpayer \$. . . for its Conference Sponsorship. In 2012, Customer paid Taxpayer \$. . . for its Conference Sponsorship, \$. . . for an Exhibitor Sponsorship, and \$. . . for a Silver Level Sponsorship. There was also other sponsorship income received by Taxpayer from Customer, but it cannot be ascertained from the Audit workpapers or the materials provided by Taxpayer whether that sponsorship income was related to Taxpayer's conferences. The Audit Division included all of this sponsorship income as service income taxable to Washington.

On December 26, 2013, the Audit Division issued Assessment No. . . . to Taxpayer, for the period January 1, 2009 through December 31, 2012, totaling \$ The assessment included \$. . . in retail sales tax, a \$. . . credit for retailing B&O tax, a \$. . . credit for wholesaling B&O tax, \$. . . in service and other activities B&O tax, \$. . . in interest, and a 5% assessment penalty of \$

Taxpayer appeals the assessment.

On appeal, Taxpayer provided various screenshots of invoices and credit memos. Taxpayer claims the credit memos show that it refunded collected retail sales tax to its customers and requests an adjustment of tax based on those credit memos.

ANALYSIS

Taxpayer's first argument, on appeal, is that the sponsorship revenue that it receives for conferences held outside of Washington should be sourced to where Customer receives the benefit of the service.

Apportionment of service income for periods prior to June 1, 2010.

Prior to June 1, 2010, RCW 82.04.460 read, in relevant part, as follows:

(1) Any person rendering services taxable under RCW 82.04.290 or 82.04.2908 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290 or 82.04.2908, apportion to this state that portion of the person's gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of the taxpayer's total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

RCW 82.04.460(1) (2004).

Under that version of RCW 82.04.460, a business may apportion its income only when both Washington and out-of-state places of business contribute to activities subject to the B&O tax under RCW 82.04.290. Det. No. 01-006, 20 WTD 124 (2001). The “place of business” requirement, however, does not mean that the business must maintain a physical location as a place of business in the other states in order to apportion its income. *See* Det. No. 87-186, 3 WTD 195 (1987). If a taxpayer has activities in a state sufficient to create nexus under Washington standards, then the taxpayer is deemed to have a “place of business” in that state for apportionment purposes. 20 WTD 124 (citing Det. No. 92-252E, 12 WTD 417 (1992) and Det. No. 92-262E, 12 WTD 431 (1992)). “[A]pportionment is not applicable if the taxable incident or activity occurs entirely within the taxing jurisdiction.” *Dravo Corp. v. City of Tacoma*, 80 Wn.2d 590, 602, 496 P.2d 504 (1972).

In this case, we find that Taxpayer, an out-of-state corporation, received sponsorship income from Customer for conferences held outside of Washington. The “taxable incident or activity” for the conferences was the activity of holding the conference. [Taxpayer had nexus in Washington because its non-resident employees visited Washington to solicit sales and consult with Taxpayer’s customers. *See Lamtec Corporation v. Dep’t of Revenue*, 170 Wn.2d 838, 850-51, 246 P.3d 788 (2011).]

WAC 458-20-194 (Rule 194), the rule applicable for apportionment prior to June 1, 2010, states that a “separate accounting” method must be used by a business if the use “results in an accurate description of gross income attributable to its Washington activities.” Rule 194(3)(a). Rule 194(b) further states that separate accounting “is accurate only when the activities that significantly contribute, directly or indirectly, to the production of income can be identified and segregated geographically.” Rule 194(b). Finally, Rule 194(3)(c) states that a “business may assign revenue from specific projects or contracts in or out of Washington by the primary place of performance.” Rule 194(3)(c). The taxable activity giving rise to the conference sponsorship income was the holding of out-of-state conferences, so separate accounting is appropriate in this case. Because the conference sponsorship income received from Customer can be specifically assigned outside of Washington, Taxpayer’s sponsorship income is to be apportioned entirely outside of Washington under RCW 82.04.460 (2004).

We remand this matter to the Audit Division to exclude any sponsorship income received by Taxpayer from Customer for out-of-state conferences from the measure of tax subject to service and other activities B&O tax for periods prior to June 1, 2010. Taxpayer has met its burden of proving that sponsorship income is not subject to service B&O tax for periods prior to June 1, [2010], but it has not met its burden of showing it is entitled to an apportionment adjustment on the remainder of its service-taxable income.

Apportionment of service income for periods after June 1, 2010.

Effective June 1, 2010:

. . . 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.

RCW 82.04.460(1) (emphasis added). "‘Apportionable income’ means gross income of the business generated from engaging in apportionable activities, including income received from apportionable activities performed outside this state if the income would be taxable under this chapter if received from activities in this state . . ." RCW 82.04.460(4)(a). It is undisputed in this case that Taxpayer provided service-taxable services to Customer.

"Apportionable activities" include activities subject to service and other activities B&O tax. RCW 82.04.046(4)(a)(vi). B&O tax may only be imposed if a person has a substantial nexus with this state. RCW 82.04.220(1); WAC 458-20-19401(1). Here, there is no dispute that Taxpayer earns apportionable income subject to the B&O tax in Washington. Taxpayer is also taxable in other states. Thus, the income Taxpayer earned from the rendition of its conventions is subject to apportionment under RCW 82.04.460.

Businesses taxable under the service & other activities B&O tax classification . . . are taxable on the gross income of the business. However, under RCW 82.04.460(1), any person earning apportionable income subject to B&O tax and also taxable in another state must 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." The income of a service business is apportioned to Washington by multiplying its apportionable income by the receipts factor. RCW 82.04.462(1).

For purposes of computing the receipts factor, RCW 82.04.462(3)(b) provides how gross income of the business generated from each apportionable activity is attributable to Washington: "(i) Where the customer received the benefit of the taxpayer's service. . . ." ² Under WAC 458-20-19402(301)(a)(i) (Rule 19402), taxpayers that can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, must attribute that apportionable receipt to the state in which the benefit is received. "Reasonable method of proportionally attributing" means a method of determining where the benefit of an activity is received and where the receipts are attributed that is uniform, consistent, and accurately reflects the market, and does not distort the taxpayer's market. Rule 19402(106)(f).

For determining where to attribute receipts, Rule 19402(301) provides a cascading list of methods. That cascading list reads, in relevant part, as follows:

(301) **Attribution of receipts generally.** . . ., this Part 3 explains how to attribute apportionable receipts. Receipts are attributed to states based on a cascading method or series of steps. The department expects that most taxpayers will attribute apportionable receipts based on (a)(i) of this subsection because the department believes that either the taxpayer will know where the benefit is actually received or a "reasonable method of proportionally attributing receipts" will generally be available. These steps are:

(a) Where the customer received the benefit of the taxpayer's service . . . ;

² Other factors may be used in a cascading order if (i) does not apply. See e.g. (ii), (iii), (iv), (v), (vi), and (vii).

(i) If a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, that apportionable receipt is attributable to the state in which the benefit is received. When a customer receives the benefit of the taxpayer's services in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state. This may be shown by application of a reasonable method of proportionally attributing the benefit among states. The result determines the receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).

....

(ii) If a taxpayer is unable to separately determine or use a reasonable method of proportionally attributing the benefit of the services in specific states under (a)(i) of this subsection, and the customer received the benefit of the service in multiple states, the apportionable receipt is attributed to the state in which the benefit of the service was primarily received. Primarily means, in this case, more than fifty percent.

Rule 19402(301)(a).

In this case, we find that Taxpayer can reasonably determine the amount of its specific apportionable sponsorship receipts. Taxpayer receives its sponsorship revenue by putting on a convention. We further find that there are benefits to sponsoring a conference, like brand awareness and product advertising, that can be attributed to locations other than the place where the conference is held. *See* Rule 19402(301)(a)(i). This is because national conference attendees come from all over the country. However, because no method of proportionally attributing the benefit of the sponsorship of the convention has been provided in this case, we will not rule on what constitutes a reasonable method.

We remand the matter to the Audit Division to determine a reasonable method of proportionally attributing the benefit of any sponsorship income received by Taxpayer from Customer for out-of-state conferences for periods after June 1, 2010. Taxpayer has 30 days from the date of this determination to provide the Audit Division with any additional documentation to assist in determining a reasonable method of proportionally attributing the sponsorship income. With respect to the non-sponsorship income, we hold that Taxpayer has not met its burden of proving that its non-sponsorship service-taxable income should be attributed by a different method than the method used by the Audit Division.

Credit Memos Are Not Proof of Sales Tax Refund

Taxpayer's second issue on appeal is a request for adjustment for unremitted sales taxes collected in error based on credit memos that Taxpayer issued to its customers. Under RCW

82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department. In Det. No. 00-092, 24 WTD 47 (2001), we held:

If sales tax was erroneously collected from the taxpayers' customers, then the over-reported sales tax comes from customers' funds. These are trust funds collected from customers for the benefit of the state. The money does not belong to the taxpayers and cannot be returned to the taxpayers until the taxpayers have refunded the over-collected sales tax to their customers.

24 WTD at 51. The Washington Supreme Court, in *Kitsap-Mason Dairymen's Ass'n v. Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312 (1970), addressed a similar issue. In *Kitsap-Mason Dairymen's Ass'n*, the taxpayer over-collected retail sales tax. It failed to remit the tax to the state. The Court held that the seller could not retain the over-collected sales tax for its own use. *Id* at 816.

In this case, Taxpayer has not met its burden of proving that it refunded unremitted sales taxes collected in error to its customers. The credit memos that Taxpayer provided do not show that sales taxes were refunded. In the absence of proof that sales taxes were indeed refunded to Taxpayer's customers, the collected and unremitted sales taxes are due. Taxpayer's petition is denied as to this issue.

5% Assessment Penalty Was Properly Assessed

RCW 82.32.090(2) provides:

If the department of revenue determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due. . . . As used in this section, "substantially underpaid" means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due for all of the types of taxes included in, and for the entire period of time covered by, the department's examination, and the amount of underpayment is at least one thousand dollars.

Because Taxpayer substantially underpaid its tax liability, the penalty was correctly imposed. RCW 82.32.105(1) provides for the waiver of penalties:

If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

Thus, the penalty may be waived only if there were circumstances beyond Taxpayer's control that caused the underpayment. WAC 458-20-228(9)(a)(ii) describes seven circumstances that justify the waiver of penalties under this criteria, which are generally immediate, unexpected, or in the nature of an emergency that resulted in the taxpayer not having reasonable time or

opportunity to obtain an extension of the due date or otherwise timely file and pay. None of those seven examples apply in this case.

Taxpayer's petition is denied on this issue.

DECISION AND DISPOSITION

Taxpayer's petition is granted in part and denied in part.

Dated this 15th day of June, 2015.