

Cite as Det. No. 13-0330, 33 WTD 213 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) DETERMINATION
Assessment of)
) No. 13-0330
...)
) Registration No. . . .
)

[1] RCW 82.04.255; ETA 3145.2009: GROSS INCOME OF THE BUSINESS – REAL ESTATE BROKERAGES FIXED SHARED EXPENSES. Amounts paid by real estate brokers for fixed shared expenses to a real estate brokerage are included in real estate brokerage's gross income of the business and taxable. That real estate brokerage deducts fixed shared expenses from real estate broker's commissions is a matter of convenience and does not change the underlying substance of the transaction.

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.

Anderson, A.L.J. – A real estate brokerage appeals service and other business activities business and occupation (“B&O”) tax¹ assessed on amounts it received from its associate brokers as payment for their share of miscellaneous office expenses. Taxpayer’s petition is denied in part and granted in part.²

ISSUES

1. Are amounts deducted by a real estate broker from commissions due to associate brokers for overhead expenses subject to B&O tax pursuant to RCW 82.04.255?
 2. Did Audit include amounts in gross income that were not payments for overhead expenses?

¹ In its petition, Taxpayer states that it is disputing the entire amount of the assessment; however, it only addresses the assessment of service and other activities B&O tax in its issues and arguments. Therefore, pursuant to WAC 458-20-100(3)(g), we need only address the assessment of service and other activities B&O tax.

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

[Taxpayer] is a real estate brokerage firm. It contracts with associate real estate brokers (“associate brokers”) to facilitate the buying, selling, and renting of real estate. Generally, these contracts determine how commissions earned from the various real estate sales or rentals and how office expenses (i.e., space, telephone, supplies, multiple listing service fees, advertising, etc.) will be shared between Taxpayer and its associate brokers. According to Taxpayer, it receives the full amount of the commissions earned on each real estate transaction and pays the service B&O tax on the gross commission amounts received. It then determines the associate broker’s share of the commission, from which it subtracts the associate broker’s share of the overhead expenses, and writes the associate broker a check for the difference, i.e., the associate broker’s share of the commission (net of expenses).

The Audit Division (“Audit”) of the Washington State Department of Revenue (the “Department”) examined Taxpayer’s books and records for the period of January 1, 2008 through September 30, 2011 (the “Audit Period”). Audit found that while Taxpayer reported the gross commission income it received and paid B&O tax on that amount, Taxpayer had not reported the amounts it received for the shared overhead expenses. On October 26, 2012, Audit issued an assessment against Taxpayer in the amount of \$... consisting of \$... in service and other activities B&O tax assessed on the amounts Taxpayer deducted from the associate brokers’ commissions as payment for overhead expenses, \$... in use/deferred retail sales tax, \$... in interest, and \$... in 5% assessment penalty.

Taxpayer appeals the assessment of service and other activities B&O tax. It argues that the assessment results in double taxation because it already reported and paid B&O tax on the gross amounts of real estate commissions and that such double taxation is prohibited.

Taxpayer also argues that Audit improperly assessed B&O tax when it classified amounts it advanced to an associate broker as additional income because these advances were already included in the broker’s share of overhead expenses. On appeal, Taxpayer provided three commission statements,³ which we shared with Audit, to substantiate this claim. Audit reviewed these statements and rejected two of them finding that: (1) one commission statement⁴ was irrelevant because the alleged advance had not been included in the measure of the service B&O tax assessed as a shared overhead expense in the assessment; and, (2) one commission statement⁵ was not credible because when Audit reviewed the document during its review of Taxpayer’s records, the document did not contain the word “Advance” and, therefore, Audit deems the document to have been altered. Audit found that the third commission statement,⁶ in combination with Federal tax information, showed that Taxpayer had made a \$... advance to the associate broker, which Taxpayer later deducted as an expense from the associate broker’s

³ All three Commission Statements were for [the same associate broker] and the following buyers and dates: [Buyer #1] – 05/25/2011; [Buyer #2] – 09/01/2011; [Buyer #30] – 11/10/2008.

⁴ [Buyer #1] – 05/25/2011.

⁵ [Buyer #2] – 11/10/2008.

⁶ [Buyer #3] – 09/01/2011.

commission payment. Therefore, Audit has agreed to reduce the measure of the service and other activities B&O tax by \$. . . .⁷ Having proved an error on this one claim, Taxpayer's petition for adjustment is granted [on this claim] and the matter will not be further discussed.

ANALYSIS

Washington imposes a B&O tax upon every person that has substantial nexus with the state for the act or privilege of engaging in business activities. RCW 82.04.220(1). The rate and measure of taxation is determined by the classification of the business activity. *Id.*

By statute, real estate brokerages are subject to a B&O tax rate of 1.5 percent, measured by the gross income of the business. RCW 82.04.255. The service and other activities B&O tax rate and tax measure is the same (1.5 percent of the gross income of the business), and the Department has advised real estate brokerages to report and pay under the service and other activities B&O tax classification. RCW 82.04.290(2); Excise Tax Advisory 3145.2009 (February 2, 2009) ("ETA 3145.2009").

"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, . . ." RCW 82.04.080. With respect to commissions on real estate transactions, RCW 82.04.255(2) provides as follows:

The measure of the tax on real estate commissions earned by the real estate firm is the gross commission earned by the particular real estate firm including that portion of the commission paid to brokers, including designated and managing brokers, in the same firm on a particular transaction. . . . Moreover, when the real estate firm has paid the tax as provided herein, brokers, including designated and managing brokers, within the same real estate firm may not be required to pay a similar tax upon the same transaction. . . .

Here, Taxpayer reported gross commissions received on real estate transactions and paid the B&O tax as required under RCW 82.04.255(2). However, this is not the gross income or the tax at issue. ETA 3145.2009 announces the Department's [position] concerning real estate brokers and their shared commissions and expenses by providing in part:

It is not unusual to make a charge to sales staff or associate brokers for providing space and other facilities such as telephone, advertising, multiple listing service, and office supplies. These charges may be a fixed amount per month or may be computed as a percentage of commissions or a percentage of sales. Generally, brokers are subject to B&O tax on these charges, as well as on the gross commissions. The B&O tax applies to these charges even if the broker is simply attempting to recover the costs, without any markup, which are incurred by having the sales staff or associate broker within the office. The recovery of these costs does not qualify as a nontaxable reimbursement under WAC 458-20-111 because the broker is not acting as the agent of the associate brokers or

⁷ Audit determined that the \$. . . reduction results in a \$. . . reduction to service and other activities B&O tax.

agents in incurring the costs, but has primary or secondary liability to pay the provider of the supplies or services.

ETA 3145.2009 goes on to provide specific examples illustrating the Department's [position]. The following example addresses Taxpayer's situation:

Option 1: The Broker and Associate agree that commissions will be split 50/50 for any real estate sold by the Associate. It is also agreed that the Associate will pay the Broker a fixed charge of \$500 per month for use of a desk, office space, advertising, and other services furnished by the Broker. The agreement provides for the Broker to deduct the fixed charge from the commission which will be paid to the Associate each month. The Associate made a sale in the current month for which the brokerage office will receive a commission of \$1,200. The Associate is entitled to receive \$600 as a commission which will be reduced by the \$500 fixed fee for "office expenses." The Broker gives the Associate a check for \$100 and retains \$1,100.

The Broker is taxable on the gross commission of \$1,200 and on the \$500 fixed fee. The total of \$1,700 is taxable under the service B&O tax classification. The Associate is not subject to the B&O tax.

Taxpayer challenges the Department's authority to assess B&O tax on both the gross commission amount and the fixed fee for shared expenses.

Washington's B&O tax is a transactional tax, and by its nature, pyramids upon a sequential set of transactions, e.g., a wholesale sale is subject to wholesaling B&O tax and a retail sale of the same item is subject to retailing B&O tax. RCW 82.04.270; RCW 82.04.250. . . .

Here there are two distinct transactions: (1) payment of real estate commissions; and (2) payment of fixed shared expenses.⁸ That Taxpayer deducts payments of fixed shared expenses from brokers' shares of real estate commissions is a matter of convenience; it does not change the underlying substance of the transactions: Taxpayer is receiving real estate commissions and amounts for fixed shared expenses and both of these amounts are gross income of the business pursuant to RCW 82.04.080. Accordingly, we deny Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 6th day of November.

⁸ If businesses engage in multiple business activities, they are liable for B&O tax on the gross income from each activity and may owe B&O tax under multiple tax classifications. *Drury the Tailor v. Jenner*, 12 Wn.2d 508, 514-15, 122 P.2d 493 (1942); RCW 82.04.440(1).