State Ruling

203-837, Tax Determination No. 14-0094-- Business and occupation-- Constitutional limitations-- Apportionment-- Domestic international sales corporation

¶203-837. Tax Determination No. 14-0094, Washington Department of Revenue, 34 WTD 92, February 26, 2015.

Business and occupation: Constitutional limitations: Apportionment: Domestic international sales corporation.– Under prior law, an interest charge domestic international sales corporation (DISC) was not allowed a refund of service and other activities business and occupation (B&O) tax paid for the period January 1, 2008, through May 31, 2010, based on its claim that it was entitled to apportion its commission income outside of Washington. The taxpayer's sole business activity, receiving commissions on its affiliate's foreign sales to receive a federal tax benefit, occurred entirely within Washington state. The Appeals Division found that, because the taxpayer had only one "place of business" and that place of business was in Washington, the taxpayer was not entitled to apportion its income to other taxing jurisdictions.

Cite as Det. No. 14-0094, 34 WTD 92 (2015)

BEFORE THE APPEALS DIVISION

DEPARTMENT OF REVENUE

STATE OF WASHINGTON

In the Matter of the Petition for Refund of …

DETERMINATION

No. 14-0094

Registration No….

> [1] RULE 194; RCW 82.04.460: B&O TAX – APPORTIONMENT – DOMESTIC INTERNATIONAL SALES CORPORATION (DISC). A taxpayer earns "commissions" from an affiliate in exchange for the taxpayer maintaining its status as a DISC, which results in a federal tax benefit. When taxpayer's status as a DISC is the only reason that it receives the "commissions" from its affiliate, and its affiliate receives the benefit of taxpayer's status as a DISC in Washington, then the taxpayer must assign 100% of its costs to Washington for periods prior to June 1, 2010.

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. – Taxpayer, an interest charge domestic international sales corporation ("DISC") petitions for a refund of service and other activities business and occupation ("B&O") tax paid for the period January 1, 2008, through May 31, 2010, claiming that it is entitled to apportion its commission income outside of Washington. Taxpayer's petition is denied. [1]

ISSUE

Whether, under WAC 458-20-194, a domestic international sales corporation ("DISC") can apportion its income outside of Washington.

FINDINGS OF FACT

[Taxpayer] is an interest charge domestic international sales corporation ("DISC") which was incorporated in 2007 in order to capture certain federal income tax benefits available to DISCs with respect to the export sales of goods sold by its affiliate, [Affiliate]. Taxpayer reported income related to contractual services it provided to its Affiliate under the service and other activities

business and occupation ("B&O") classification. On May 10, 2012, Taxpayer requested a refund of all taxes paid for the period January 1, 2008, through December 31, 2011, for services associated with the sales of tangible products by its Affiliate. On or about December 7, 2012, the Taxpayer Account Administration ("TAA") Division of the Department of Revenue ("Department") allowed the refund for the period June 1, 2010 through December 31, 2011, [2] but denied the refund of all B&O taxes paid prior to June 1, 2010.

Taxpayer maintains a Washington address, business location, and a bank account in Washington, and its activities consist of generating a federal tax benefit on commissions of certain export sales of its Affiliate's goods. Taxpayer has no employees and exists for the sole purpose of capturing federal income tax benefits. Taxpayer does not lease any property or maintain physical facilities either in Washington or in any other state. Taxpayer has no sales customers and makes no sales but, instead, receives commission income from its Affiliate in an amount calculated to take advantage of the federal tax benefits conferred to DISCs by federal law. Those tax benefits arise from statutorily defined "commissions" earned on export sales. 26 U.S.C §994. A DISC, as a tax-exempt entity, pays no federal tax on the commission income. 26 U.S.C. §992, 995. When the DISC distributes income to individual shareholders, their dividend income is taxed at the qualified dividend rate. 26 U.S.C. §995. Taxpayer has minimal costs of operation, consisting primarily in the administrative costs of maintaining a bank account and payment for the professional services required to maintain its status as a DISC, which are provided by an accounting firm located in Washington State.

On July 10, 2007, Taxpayer and Affiliate entered into a Commission Agreement. The Commission Agreement was signed on behalf of Taxpayer and Affiliate by the same person, who was simultaneously serving as Taxpayer's president and an authorized signatory of Affiliate. The Commission Agreement states that the parties intended Taxpayer to qualify as a DISC, consistent with Section 992 of the Internal Revenue Code and the applicable U.S. Department of Treasury regulations.

The Commission Agreement states that Taxpayer shall act as a commission agent with respect to Affiliate's sales of certain products located outside the United States, as specified by Affiliate. Affiliate is responsible for soliciting all orders in its own name and is responsible for all its own billings and collections. Taxpayer receives a commission fee calculated in accordance with Section 994 of the Internal Revenue Code and applicable Treasury regulations to take advantage of the federal income tax benefits available to DISCs. The condition for payment of the commission fee depends upon Taxpayer qualifying as a DISC and the tax benefits for DISCs continuing to be available to Taxpayer in the applicable federal statutes and regulations. The parties agree that the Commission Agreement is governed by the laws of the State of Washington.

Taxpayer appealed the TAA Division's denial of its refund request of B&O taxes paid for periods prior to June 1, 2010.

ANALYSIS

RCW 82.04.290 imposes a tax on those persons whose business activities consist of performing services. The statute applies to every person doing business "within this state." That language reflects the requirement of the Due Process Clause of the United States Constitution, which has been interpreted to require a substantial connection between a state's taxing authority and the person the state seeks to tax. *See* Det. No. 87-195, 3 WTD 195 (1987) (citing *Chicago Bridge and Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 820, 659 P.2d 463 (1983)). DISCs are U.S. companies which were created to provide a method of tax deferral for a part of their U.S. parent companies' income derived from export sales.

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). [3]

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).

WAC 458-20-194 ("Rule 194"), the regulation promulgated to administer income apportionment reads, in relevant part, as follows:

> (b) **Place of business requirement.** A taxpayer must maintain places of business within and without Washington that contribute to the rendition of its services in order to apportion its income. This "place of business" requirement, however, does not mean that the taxpayer maintain a physical location as a place of business in another taxing jurisdiction in order to apportion its income. If a taxpayer has activities in a jurisdiction sufficient to create nexus under Washington standards, then the taxpayer is deemed to have a "place of business" in that jurisdiction for apportionment purposes.

Rule 194(4)(b).

In this case, Taxpayer has failed to allege any facts tending to show that it maintains a place of business outside of Washington. Taxpayer claims that because it earns sales "commission" revenue for federal income tax purposes as a result of the export sales of its Affiliate, it has a presence in the foreign jurisdictions where the sales take place. However, Taxpayer's Commission Agreement with its Affiliate makes it clear that Taxpayer does not actually engage in any actual sales activity. Taxpayer simply receives "commissions" on Affiliate's foreign sales, in an amount designated by Affiliate, for the sole stated purpose of receiving a statutory federal tax benefit.

Because Taxpayer exists solely to receive a federal tax benefit on the sales of its Affiliate and does not actually engage in any foreign sales activity, we find that it does not have any business activities in the locations where Affiliate makes the foreign sales. Any out-of-state activities, including export sales activity, are performed exclusively by Affiliate on Affiliate's own behalf. Taxpayer engages in no out-of-state activities whatsoever. We find that Taxpayer has taxable nexus in Washington as a result of its Washington address, business location, bank account, and because it entered into a commission agreement with its sole customer and Affiliate in Washington. Taxpayer's sole business activity, receiving commissions on its Affiliate's foreign sales to receive a federal tax benefit, occurs entirely within Washington State. RCW 82.04.460(1); Rule 194(4)(b). Because we find that Taxpayer has only one "place of business" and that place of business is in Washington, we hold that Taxpayer is not entitled to apportion its income to other taxing jurisdictions.

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DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 12th day of March 2014.

Footnotes

1	Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
2	This refund was based on an application of the "economic nexus" standards enacted by the Washington legislature, effective June 1, 2010. *See* RCW 82.04.067. The refund was granted as a credit in Invoice No. 002, Document No. 201308274.
3	On June 1, 2010, the Washington legislature enacted an "economic nexus" standard and Washington adopted "single factor receipts apportionment" as the proper methodology for apportioning income. *See* RCW 82.04.067; 82.04.460; RCW 82.04.462; WAC 458-20-19402. Because "economic nexus" and "single factor receipts apportionment" are inapplicable to the time period in question in this appeal, we do not address them in this determination.