

Cite as Det. No. 15-0297, 35 WTD 443 (2016)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of ) D E T E R M I N A T I O N  
Assessment of ) No. 15-0297  
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... ) Registration No. ....  
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RULE 163; RCW 48.14.080; RCW 82.04.320: B&O TAX – EXEMPTION – INSURANCE BUSINESS. Taxpayers do not qualify for the exemption in respect to insurance business upon which a tax based on gross premiums is paid to the state where the receipts are for services that are not incidental to accomplishing the insurance function and related exclusively to the insurance business that generates the premium taxes.

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.

Margolis, A.L.J. – An insurance company and its wholly owned broker/dealer . . . appeal assessments of service and other activities business and occupation (B&O) tax on grounds that the receipts are exempt as functionally related to insurance business. We deny the petitions.<sup>1</sup>

## ISSUE

Whether, under RCW 48.14.080 and RCW 82.04.320, Taxpayers' receipts, including receipts in connection with variable annuities, are functionally related to insurance business subject to gross premiums tax and exempt from B&O tax.

## FINDINGS OF FACT

[Insurance Co.] is registered with the Washington State Office of the Insurance Commissioner (“OIC”) and authorized to sell disability and life insurance in Washington. Insurance Co. files returns with OIC and reports annuity considerations, but pays no gross annuities taxes. . . . Insurance Co. provides various services to its affiliated companies, including management services and purchasing supplies, for which it receives payment from those companies.

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

[Broker/dealer] is wholly owned by Insurance Co. It is a broker/dealer that distributes various products, including annuities and mutual funds, and provides related services.<sup>2</sup> (Insurance Co. and Broker/dealer are collectively referred to as “Taxpayers”).

The Department of Revenue’s (Department’s) Audit Division (Audit) examined Insurance Co.’s records for the period of January 1, 2008 through December 31, 2012, and on June 25, 2014, assessed Insurance Co. \$ . . . . The assessment is comprised of \$ . . . in service and other activities B&O tax, \$ . . . in interest, and \$ . . . in a 5% assessment penalty.

Audit examined Broker/dealer’s records for two periods, and on November 19, 2013, issued separate assessments based on unreported revenues for each of these periods. Audit examined Broker/dealer’s records for the period of January 1, 2006 through December 31, 2008, and assessed Broker/dealer \$ . . . . The assessment is comprised of \$ . . . in service and other activities B&O tax, \$ . . . in 25% delinquent return penalties, \$ . . . in interest, \$ . . . in a 5% assessment penalty, and \$ . . . in a 5% unregistered business penalty. Audit examined Broker/dealer’s records for the period January 1, 2009 through December 31, 2012, and assessed Broker/dealer \$ . . . . The assessment is comprised of \$ . . . in service and other activities B&O tax, \$ . . . in 25% delinquent penalties, \$ . . . in interest, \$ . . . in a 5% assessment penalty, and \$ . . . in a 5% unregistered business penalty.

At issue in this matter is B&O tax that Audit assessed on the payments Insurance Co. received from two affiliated entities, Broker/dealer and [Trust Co.].<sup>3,4</sup> Also at issue is B&O tax that Audit assessed on receipts by Broker/dealer, which Taxpayer asserts are derived mostly from the distribution of variable annuities.<sup>5</sup>

## ANALYSIS

Washington’s B&O tax is imposed on every person “for the act or privilege of engaging in business activities” and applies to the gross income of the business. RCW 82.04.220. “Business” for B&O tax purposes includes “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. Gross income of the business includes compensation for the rendition of services without any deduction for any expense whatsoever paid or accrued. RCW 82.04.080.

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<sup>2</sup> . . .

<sup>3</sup> Subject to various terms and agreements, the services that Insurance Co. performs for Broker/dealer and Trust Co. include providing personnel and facilities; performing accounting, bookkeeping services, and treasury tasks; tax related services; operations support and administration; recordkeeping; data processing; communications; legal advisory services; corporate secretarial services; auditing services; personnel services; public relations services; and corporate insurance, marketing, and consulting services . . . .

<sup>4</sup> Trust Co. is indirectly wholly owned by Insurance Co., and provides banking and trust services. Trust Co. is a federal savings bank established . . . to provide services primarily to Insurance Co. participants and non-profit organizations, and . . . acquired the right to offer deposit and loan products to the public . . . .

<sup>5</sup> Taxpayers provided a document indicating that revenues derived from distribution activities related to the issuance of variable annuity contracts by . . . (a companion company to Insurance Co.) and Insurance Co., represent 72.8% and 4.6% of revenues, respectively . . . .

The Legislature “intended to impose the business and occupation tax upon virtually all business activities carried on within the state.” *Simpson Inv. Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)). Unlike the federal income tax, the B&O tax is not a tax on profit, net gain, capital gain, or sales “but a tax on the total money or money’s worth received in the course of doing business.” *Budget Rent-A-Car of Wash.-Oregon v. Dep’t of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972). The B&O tax provisions “leave practically no business and commerce free of the business and occupation tax.” *Id.* at 175.

The B&O tax rate varies according to the nature, or classification, of the business activity. *See generally*, ch. 82.04 RCW. Business activities other than those classified elsewhere in Chapter 82.04 RCW fall under the catch-all service and other activities B&O tax classification. RCW 82.04.290(2). In general, insurance companies and brokers are subject to B&O tax under this classification. WAC 458-20-163(1) (Rule 163); WAC 458-20-224(2).

RCW 82.04.320 provides an exemption for insurance business as follows:

This chapter shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state: PROVIDED, That the provisions of this section shall not exempt any person engaging in the business of representing any insurance company, whether as general or local agent, or acting as broker for such companies. . . .

(Emphasis added.)

The tax “based on gross premiums” mentioned in RCW 82.04.320 is the tax on premiums imposed under 48.14 RCW. RCW 48.14.080 states that “the taxes imposed by this title are in lieu of all other taxes, except as otherwise provided in this section.”<sup>6</sup> The tax is imposed [on insurers] under RCW 48.14.020 on “all premiums” with certain exclusions.<sup>[7]</sup> One such exclusion is for “consideration received by an insurer for the granting of an annuity.” RCW 48.14.020(1).

WAC 458-20-163 (Rule 163) is the administrative rule that explains tax liabilities for insurance companies. It explains the exemption under RCW 82.04.320 as follows (in pertinent part):

RCW 82.04.320 provides an exemption to any person with respect to insurance business upon which a tax based on gross premiums is paid to the state of Washington. It should be noted, however, that the law provides expressly that this exemption does not extend to “any person engaging in the business of representing any insurance company, whether as general or local agent, or acting as broker for such companies” . . . . The exemption also

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<sup>6</sup> Insurers are subject to sales tax or use tax on their purchases of tangible personal property, extended warranties, digital goods and codes, and retail services. They are also obligated to collect sales tax on their sales of these items. <http://dor.wa.gov/Content/DoingBusiness/BusinessTypes/Industry/insurance/default> (last accessed September 15, 2015).

<sup>7</sup> [Under RCW 48.01.050, an “insurer” is a person “engaged in the business of making contracts of insurance.”]

does not apply to any business engaged in by an insurance company other than its insurance business.

Rule 163(2)(a) (emphasis added.)

The exemption includes activities “functionally related to the taxpayer’s conduct of its insurance business,” which are “activities incidental to accomplishing the insurance function.” Det. No. 88-311A, 9 WTD 293, 297 (1990). We explained in 9 WTD 293 how this inclusion for functionally related activities applies to services performed by an affiliate of the insurance business as follows (in pertinent part, footnote omitted):

Services performed for an affiliate will be considered functionally related, provided they are rendered in the regular course of the taxpayer's insurance business and relate exclusively to the affiliate's insurance business. General administrative services such as accounting, personnel and data processing are considered functionally related when performed for an affiliate's insurance business. Legal services provided to an affiliate that relate to its insurance business are also considered functionally related. If the affiliate is engaged in one or more business activities not related to the insurance business, services rendered to the affiliate are taxable to the extent they relate to other business activities. For example, accounting and data processing services provided to an affiliate whose sole activity is providing financial counseling to individuals would not be considered functionally related to the insurance business.

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The assessment in question involves expense allocations to affiliates for services performed by the taxpayer's home and divisional offices. These services include data processing, accounting, legal, personnel, education and administration rendered to the taxpayer's affiliates in the course of its insurance business. Each of the taxpayer's affiliates is engaged in the insurance business to which these services are functionally related.

*Id.* at 297-298. (Emphasis added.)

... [W]e find that in order for the receipts to be exempt from B&O tax, they must be for services incidental to accomplishing the insurance function, and related exclusively to the insurance business that generates the premium taxes.

Taxpayers argue that they are unlike most insurance groups such that the exemption should apply to all of the receipts at issue. They assert that because they are ultimately not-for-profit and benefits from subsidiary earnings accrue to insurance policyholders and thus are part of the “insurance chain,” the receipts are functionally related to insurance business and thus exempt. Essentially, Taxpayers assert that we should broadly apply the “functionally related” test and grant the exemption on grounds that insurance policyholders are the ultimate beneficiaries. We find no grounds for this broad application.

Taxpayers also argue that variable annuities are insurance products, so receipts in connection with these products are “functionally related” and qualify for exemption. However, because the selling of annuities is a separate line of business, one that is not subject to the premiums tax or integral to the insurance business, they do not qualify for exemption under RCW [82.04.320]. The gross premiums tax does not apply to these receipts, so the gross premiums tax cannot be in lieu of B&O tax on receipts functionally related to annuities under RCW 48.14.080. The receipts at issue are not related exclusively to the insurance business that generates the premium taxes. Further, although variable annuities have aspects of an insurance product, they are primarily a securities product. This is evident by looking at how Federal and Washington State laws treat variable annuities and how the Department taxes the sale of this product.

The U.S. Securities and Exchange Commission considers variable annuities to be securities. *See* <http://www.sec.gov/answers/annuity.htm> (“Variable annuities are securities regulated by the SEC”) (last accessed September 21, 2015). Washington State law considers variable annuities to be securities. RCW 48.18A.060; <http://dfi.wa.gov/news/press/new-washington-state-law-defines-variable-annuities-securities> (last accessed September 21, 2015); <http://www.insurance.wa.gov/your-insurance/annuities/types-of-annuities> (“Agents and brokers who sell variable annuities must be registered with the Department of Financial Institutions.” ([www.dfi.wa.gov](http://www.dfi.wa.gov)) (last accessed September 21, 2015)). The Department taxes sellers of variable annuities like sellers of securities rather than insurance producers. WAC 458-20-164; Det. No. 95-029, 19 WTD 739 (2000) (“[T]he usual variable annuity is primarily a securities product and the person selling should be taxed for B&O tax purposes as selling securities.”).<sup>8</sup>

In conclusion, because Taxpayers have not established that RCW 82.04.320 applies to Insurance Co. receipts from affiliated companies not functionally related to insurance business subject to premiums tax, nor receipts by Broker/dealer related to variable annuities, we sustain the assessments.

#### DECISION AND DISPOSITION

Taxpayers’ petitions are denied.

Dated this 3rd day of November, 2015.

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<sup>8</sup> We also note that because the B&O tax exemption under RCW 82.04.320 does not apply to any person engaged in the business of representing any insurance company or acting as a broker for an insurance company, and Broker/dealer is engaged in such business, Broker/dealer explicitly does not qualify for the exemption.