

Cite as Det. No. 15-0107, 35 WTD 178 (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. 15-0107
)
...) Registration No. . . .
)

[1] RULE 207, RULE 111; RCW 82.04.080: BUSINESS AND OCCUPATION TAX – SERVICE AND OTHER BUSINESS ACTIVITIES – GROSS INCOME OF THE BUSINESS – LEGAL SERVICES – ADVANCES AND REIMBURSEMENTS – DEDUCTIONS. The taxpayer appealed the assessment of business and occupation tax on income generated by payments the taxpayer received from clients wherein the taxpayer forwarded a portion of the payment to a technology company that provided access to, management of, and customer service associated with a website that offered online legal services through an attorney. The taxpayer contended that it was not liable for payment of business and occupation tax on the amounts received and then forwarded to the technology company. The Department determined that the amounts the taxpayer forwarded to the technology company were a cost of providing legal services to clients and, thus, were not deductible from the measure of the taxpayer's business and occupation tax liability. In addition, the record contained no evidence that anyone, other than the taxpayer, had personal liability to pay the technology company for its services.

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.

Valentine, A.L.J. – A taxpayer appeals the assessment of service and other activities business and occupation (B&O) tax, penalties, and interest on income the Department of Revenue (Department) disallowed as deductible advances. The taxpayer's petition is denied.¹

ISSUE

Pursuant to RCW 82.04.080, WAC 458-20-207 (Rule 207), and WAC 458-20-111 (Rule 111), are payments from an attorney to a technology company for access to a website used in providing legal services deductible from gross income for B&O tax purposes?

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

FINDINGS OF FACT

The Department's Audit Division (Audit) audited the business activities of [Taxpayer] for the time-period of August 1, 2011 through December 31, 2013. Taxpayer's business activities, during the audit period, consisted of providing marriage dissolution services via a website. Specifically, Taxpayer provided what it refers to as "unbundled legal services" related to uncontested divorces via the website According to Taxpayer, a qualified individual can complete his or her uncontested dissolution of marriage in Washington State through the website with the guidance of a licensed attorney.

Taxpayer does not own the website or the domain name. The company [Technology Company] owned [the website] during the audit period. The website owner itself did not provide legal services; it is a technology company and does not employ any attorneys. Taxpayer has no ownership interest in [Technology Company]. Taxpayer provided the unbundled legal services offered via the website and processed the credit card transactions generated by and through the website. Taxpayer managed all of the financial transactions and all funds were deposited into its bank account. Most payments were made by credit card.

The cost of the basic service offered (preparation of documents for uncontested divorce) is \$² The client makes payment in full to Taxpayer via the website. Taxpayer then forwards \$. . . of the \$. . . to [Technology Company] for the technology, management, and customer service associated with the website. Taxpayer keeps the remaining balance as payment for the actual legal services. During the audit period, Taxpayer reported and paid B&O tax solely on the portion of the fees it did not forward to [Technology Company].

Taxpayer explains the reasoning behind how payments are made as follows:³

[Taxpayer] collects all revenue because a portion of the total revenue is payment for legal services. It is improper for a non-attorney to collect fees for legal services, so [Technology Company] is not permitted to collect payment for the entire transaction. Rather than require a customer/client to process two separate transactions, [Taxpayer] manages the processing of the entire payment.

As each new customer/client makes payment, \$. . . is immediately due and payable to [Technology Company]. Those funds are broken into two separate client costs: 1) a \$. . . account activation fee; and 2) a \$. . . account management fee. The \$. . . fee provides the client access to the technology that enables them to input the needed information. The \$. . . fee provides the account management necessary to smoothly complete the process via the online channels.

On a weekly basis, [Technology Company] invoices [Taxpayer], and the payment of the invoice is made each Monday via a wire transfer. Often, more than one wire is sent in a week, so that funds paid by new clients/customers reach [Technology Company] that

² In the alternative, a client may make two equal payments of \$

³ See Taxpayer's brief dated May 28, 2014.

much quicker. When a new client/customer pays either \$. . . or \$. . . , they have immediate access to the technology created by [Technology Company].

In the rare case of a refund, Taxpayer pays the client/customer the refund from its bank account and then Technology Company refunds the account activation fee and account management fee to Taxpayer. Since its inception, Taxpayer has deducted the account activation fees and the account management fees paid to Technology Company from its B&O tax payments as advances under Rule 111.

ANALYSIS

RCW 82.04.220 imposes the B&O tax “for the act or privilege of engaging in business activities” in Washington. “[T]he legislative purpose behind the B&O tax scheme is to tax virtually all business activity in the state.” *Impecoven v. Dep’t of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992). RCW 82.04.140 defines “business” as “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.”

Washington’s B&O tax is 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.” RCW 82.04.220(1). RCW 82.04.080(1) defines “gross income of the business” as follows:

“*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, *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.*

(Emphasis added.)

Rule 207 is the Department’s administrative regulation that “explains the taxability of amounts received for legal, arbitration, and mediation services.” Rule 207 explains that the service and other activities B&O tax classification applies to gross income obtained from these services. Under Rule 207(3)(a), gross income obtained from providing legal, arbitration, or mediation services “generally includes the amount of compensation paid . . . and amounts attributable to providing those services . . .”

Amounts an attorney receives from a client for direct litigation costs, however, “do not constitute gross income to the attorney.” Rule 207(3)(c)(ii). The following direct litigation costs are not included in an attorney’s gross income: 1) filing fees and court costs, 2) process server and messenger fees, 3) court reporter fees, 4) expert witness fees, and 5) costs of associate counsel. *Id.*

In addition, some amounts classified as advances and reimbursements may be excluded from an attorney's gross income. But these costs are excludable "only when the attorney does not have any personal liability to the third-party provider for their payment." Rule 207(3)(c)(iii). *See also* WAC 458-20-111 (Advances and Reimbursements).

In this case, Taxpayer charged the client the full payment for document preparation and review. Taxpayer then forwarded a portion of the client's payment to Technology Company to cover the costs of technology, management, and customer service associated with the website. We conclude that Taxpayer's payments to Technology Company constituted a cost of providing legal services to clients via the website

The record contains no evidence that the clients who used the website had any direct payment liability to Technology Company for the technology, management, and customer service provided through the website. Taxpayer paid Technology Company for the technology and associated services in order to provide legal services via the website. There is nothing in the record to suggest that anyone, other than Taxpayer, had personal liability to pay Technology Company. Thus, under Rule 207 and Rule 111, these costs to Taxpayer may not be deducted from its gross income subject to B&O tax.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 21st day of April, 2015.