

State Ruling

204-794, Determination No. 21-0102-- Business and Occupation Tax-- Business and occupation tax constitutional limitations-- Apportionment-- Real estate property tax payment services

¶204-794. Determination No. 21-0102, Washington Department of Revenue, 41 WTD 396, October 26, 2022.

Business and Occupation Tax: Business and occupation tax constitutional limitations: Apportionment: Real estate property tax payment services.— The Washington Department of Revenue (department) properly assessed service and other activities business and occupation (B&O) tax on revenues earned by a residential real estate property tax payment services provider (taxpayer) because the services were related to Washington-based real property. In this matter, the taxpayer rendered services for banks, mortgage companies, and other financial institutions (lenders). Upon audit, the department found that the taxpayer's services were related to real property and that the local governments were the beneficiaries of these services, and it assessed service and other activities B&O tax on the basis of where the properties were located. The taxpayer argued that it did not provide services related to real property and that its customers were the actual beneficiaries of its services.

Upon review, the Administrative Review and Hearings Division noted that the taxpayer's services consisted of fulfilling the lenders' obligations to real property owners by paying property taxes on the real property and ensuring the property taxes were paid on time and to the correct taxing authority. Therefore, the services were related to real property, and the income received from these services should be attributed based on where the real property was located. Accordingly, the taxpayer's petition was denied.

Cite as Det. No. 21-0102, 41 WTD 396 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION

DEPARTMENT OF REVENUE

STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of ...

DETERMINATION

No. 21-0102

Registration No....

WAC 458-20-19402; RCW 82.04.462: ATTRIBUTION – BENEFIT OF SERVICE RELATED TO REAL PROPERTY: Real estate property tax payment services are services related to real property and are properly attributed to where the real property subject to the property tax is located.

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.

Orwick, T.R.O. – A business providing residential real estate property tax payment services protests the Department of Revenue's (Department) assessment of service and other activities business and occupation (B&O) tax, arguing that it does not provide services related to real property and its customers are the beneficiaries of its services. We deny the petition. ¹

ISSUE

Whether a business's residential real estate property tax outsourcing services are related to real property and attributable to Washington under RCW 82.04.462 and WAC 458-20-19402.

FINDINGS OF FACT

... (Taxpayer) performs residential real estate property tax payment services for banks, mortgage companies and other financial institutions (Lenders). Taxpayer maintains a database through which it is able to determine the property tax due on a particular property. Taxpayer informs Lenders of the amount of property tax due, and the Lenders include it as part of the property owners' payments. The property owners make payments to the Lenders and the Lenders place the appropriate funds for the property tax payment in escrow accounts. When the property taxes are due, the Lenders transfer funds to Taxpayer who then remits payment to the local government where the property tax is due. Taxpayer charges the Lenders a fee for providing this service.

The Department's Audit Division (Audit) reviewed Taxpayer's records for the period of January 1, 2016, through December 31, 2019 (Audit Period). Audit found that Taxpayer's services are related to real property and the local governments are the beneficiaries of Taxpayer's services. Based on those findings, Audit concluded that receipts for Taxpayer's services should be sourced to where the real properties are located. On July 27, 2020, the Department issued an assessment (Assessment) against Taxpayer. The Assessment totaled \$..., which consisted of \$... in service and other activities B&O tax liability, \$... in interest and \$... in penalties.²

Taxpayer timely petitioned for administrative review of the Assessment. Taxpayer argues that its services are not related to real property because its services are not described or enumerated under WAC 458-20-19402(303)(a) or (304)(a). Taxpayer asserts that, because its services are not related to real property, Taxpayer's receipts should be sourced to the location where the customer receives the benefit of the services. Taxpayer identifies its customers as the Lenders and asserts the Lenders receive the benefit of the service where the Lenders are located. Taxpayer further argues that the Lenders are the recipients of Taxpayer's services because the Lenders specifically hired Taxpayer to provide the service of ensuring property tax payments were made timely to the correct local government. The arrangement between Taxpayer and Lenders allows the Lenders to outsource this tax payment process and avoid the need to hire staff in-house to complete the same process.

ANALYSIS

In Washington, "there is levied and collected from every person that has a substantial nexus with this state ... a tax for the act or privilege of engaging in business activities." RCW 82.04.220. Taxpayer does not dispute that it has nexus with Washington, and is, therefore, generally subject to B&O tax in Washington. The B&O tax measure is "the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.* The rate used is determined by the type of activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW. Income from any business activity that is not expressly classified in Chapter 82.04 RCW is taxed under the service and other activities B&O tax classification. RCW 82.04.290(2). There is no dispute that Taxpayer's business activity is subject to service and other activities B&O tax. There is also no dispute that Taxpayer's business activity is also taxable in other states.

RCW 82.04.460, which addresses when income is taxable in both Washington and another state, requires that income from business activity taxable under the service and other activities B&O tax classification be apportioned "to this state, in accordance with RCW 82.04.462, that portion of the [taxpayer's] apportionable income derived from business activities performed within this state."

To determine taxable income in such cases, a taxpayer's total apportionable income is multiplied by a fraction referred to as the "receipts factor." RCW 82.04.462(3)(a). The numerator of the receipts factor is Washington apportionable receipts and the denominator is the worldwide apportionable receipts minus any "throw-out income." *See id.*; WAC 458-20-19402(402). In essence, the receipts factor becomes the percentage by which a taxpayer's gross income is multiplied to derive the portion of that taxpayer's total gross income that is taxable in Washington.

RCW 82.04.462(3)(b) provides for the following series of cascading steps for attributing

apportionable income to Washington for the purpose of determining the numerator of the receipts factor:

... [F]or purposes of computing the receipts factor, gross income of the business generated from each apportionable activity is attributable to the state:

(i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property. When a customer receives the benefit of the taxpayer's services or uses the taxpayer's intangible property 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 or intangible property used by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state.

(ii) If the customer received the benefit of the service or used the intangible property in more than one state, ... gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.

(Emphasis added.)

In sum, if a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the service received in a state, the apportionable receipt is attributable to the state in which the benefit is received. However, if the location of where the benefit of the service is received cannot be determined, use of this method is not appropriate. In such cases, the taxpayer should look to the other methods described in RCW 82.04.462(3)(b) (iii)–(vii), in descending order. See Det. No. 13-0319, 34 WTD 452 (2015).

WAC 458-20-19402(301) further explains how to attribute apportionable receipts, in relevant parts:

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 ...;
 - (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. 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.
- (b) If the taxpayer is unable to attribute an apportionable receipt under (a) of this subsection, the apportionable receipt must be attributed to the state from which the customer ordered the service.

Here, the parties do not dispute that Taxpayer's gross income must be attributed consistent with

RCW 82.04.462(3)(b)(i) and WAC 458-20-19402(301)(a)(i) to where Taxpayer's customers, [the Lenders,] received the benefit of Taxpayer's services. [The next inquiry is where the Lenders received the benefit of Taxpayer's services.]

The "benefit of the taxpayer's service" is not defined in statute. WAC 458-20-19402(303), however, defines that term in a variety of ways, depending on the factual circumstances:

(a) If the taxpayer's service relates to real property, then the benefit is received where the real property is located. The following is a nonexclusive list of services that relate to real property:

- (i) Architectural;
- (ii) Surveying;
- (iii) Janitorial;
- (iv) Security;
- (v) Appraisals; and
- (vi) Real estate brokerage.

...

(c) If the Taxpayer's service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer's business activities, then the benefit is received where the customer's related business activities occur. The following is a nonexclusive list of business-related services:

- (i) Developing a business management plan;
- (ii) Commission sales (other than sales of real or tangible personal property);
- (iii) Debt collection services;
- (iv) Legal and accounting services not specific to real or tangible personal property;
- (v) Advertising services; and
- (vi) Theater presentations

WAC 458-20-19402(304)(a) and (304)(c) provide additional examples of services related to real property and services related to customer's business activities, respectively.

Taxpayer argues that its services do not fall within any of the list of examples of services provided under WAC 458-20-19402(303)(a) and (304)(a), and, as such, are not related to real property. Because, Taxpayer argues, its services are not related to real property, Taxpayer's receipts should be sourced to the location of where the customer receives the benefit of Taxpayer's services, pursuant to WAC 458-20-19402(303)(c). Taxpayer contends that the Lenders are the customers of Taxpayer's services, and the associated income should be attributed to where the Lenders' related business activities occur. Here, Taxpayer claims that location is the Lenders' headquarters.

Taxpayer's services do not fall directly into any of the categories of enumerated examples listed in WAC 458-20-19402(303)(a). However, WAC 458-20-19402(303)(a) states that it is a nonexclusive list of examples and is meant to illustrate the types of activities related to real property. Taxpayer's services consist of [fulfilling the Lenders' obligations to real property owners, to pay property taxes on the real property using the escrow funds the Lenders collected from the owners]. Paying property taxes is a [necessary feature] of real property ownership. Failure to pay property taxes can result in additional fines, liens, and foreclosure. Taxpayer's services ensure that the property taxes are paid to the correct taxing authority and paid on time. As such, we find that Taxpayer's services are related to real property and are of a similar nature to those activities listed in the examples in WAC 458-20-19402(303)(a). ^[3] Therefore, as Taxpayer's services are related to real property, income received from Taxpayer's services should be attributed based on

where the real property is located.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 21st day of June 2021.

Footnotes

1	Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
2	The penalties consisted of a \$... substantial underpayment [penalty] and \$... in delinquent penalties.
[3]	The payment of real property taxes is a necessary feature of real property ownership; therefore, the Taxpayer's services can be more accurately described as relating to, or "directly connected to real property, such as architectural, surveying, etc...." See Det No.17-0148, 39 WTD 072 (2020). We note, however, that the attribution analysis under both WAC 458-20-19402(303)(a) and (303)(c) arrive at the same result.