

Cite as Det No. 10-0375, 32 WTD 74 (2013)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Refund	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 10-0375
	)	
...	)	Registration No. . . .
	)	Document No. . . .
	)	Docket No. . . .
	)	

- [1] RULE 229; RCW 82.32.170: REFUNDS – SUBSTANTIATION REQUIREMENT. Rule 229(3)(b)(vii) states that if the Department does not receive the necessary substantiation within the applicable time period, the Department “shall” deny the claim for lack of adequate substantiation. Here, TAA properly denied Taxpayer’s refund claim for lack of substantiation.
- [2] RULE 193D: B&O TAX – EXEMPTION – INTERSTATE COMMERCE. Rule 193D clearly states that “[n]o deduction is permitted with respect to the gross income derived from activities which are ancillary to transportation across the state’s boundaries . . . .” The great majority of Taxpayer’s business activities were freight brokering, which is not deductible.
- [3] RCW 82.04.260: B&O TAX – EXEMPTION – INTERNATIONAL FREIGHT BROKERING OR FORWARDING. In order to qualify for the lower preferential tax rate under RCW 82.04.260, Taxpayer must show that it engaged in *international* freight brokering or forwarding. While Taxpayer may have provided documentation of freight forwarding and freight brokering activities; it has failed to show that it was engaged in those activities internationally.

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.

Klohe, A.L.J. – Taxpayer, a transportation and logistics services provider, appeals a denial of a request for refund, arguing it provided sufficient substantiation for its refund claim under RCW 82.32.060 and WAC 458-20-229 (Rule 229) and that its business activities in Washington should

be subject to the lower business and occupation (B&O) tax rate of .00275 for international freight brokers. Taxpayer's petition is denied.<sup>1</sup>

### ISSUES

1. Did taxpayer meet the substantiation requirements for its refund claim as required by RCW 82.32.060 and WAC 458-20-229?
2. Is taxpayer entitled to take the interstate sales deduction pursuant to WAC 458-20-193D (Rule 193D)?
3. . . .
4. Are taxpayer's domestic freight brokering and freight forwarding gross receipts properly classified as service and other activities B&O income under RCW 82.04.290 rather than international freight brokering under RCW 82.04.260(5)?

### FINDINGS OF FACT

[Taxpayer, an out-of-state] corporation . . . , is a wholly-owned subsidiary of [a] corporation [headquartered in another state], and its parent company, [a corporation located outside the U.S.]. Taxpayer provides complete supply chain transportation and logistics services to retailers and importers, including global logistics and freight management services that integrate various activities such as ocean transportation, drayage, distribution, reallocation programs, land transportation, warehousing, and software for supply chain tracking and tracing.

In Washington, Taxpayer describes its activities primarily as a freight broker. As a freight broker, Taxpayer states that it arranges for the shipment and delivery of goods, while acting as a middleman between the buyer, seller, and third-party delivery companies. In certain circumstances, Taxpayer also describes its activities as a freight forwarder whereby Taxpayer states that it accepts small shipments and assumes liability and responsibility to ensure the goods reach their final destination undamaged.

On August 21, 2008, Taxpayer requested a letter ruling from the Taxpayer Information and Education Division (TI&E) of the Department of Revenue (Department), as to whether it should report its income under the service and other activities B&O classification or the classification for "freight brokers." On September 23, 2008, TI&E responded that while Taxpayer's activities were those of a freight broker, they were only involved in domestic hauls – not international. As explained by TI&E in its Letter Ruling, the special B&O tax classification and rate found in RCW 82.04.260(5) is limited to *international* charter freight brokers only. Finally, TI&E's Letter Ruling concluded that providing domestic freight brokering services is subject to the

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

service and other activities classification.

As part of its September 23, 2008, Letter Ruling, TI&E provided the following definitions of a freight broker and freight forwarder:

**Freight broker** is defined in industry terms cited by the Internal Revenue Service as an agent for the independent contractor that arranges jobs for the independent contractors. **Freight forwarder** is defined in industry terms cited by the Internal Revenue Service . . . as an agent who makes the arrangements for transportation of freight from the shipper to the consignee. The freight forwarder issues a bill of lading from the origin to the destination, and takes full responsibility of the freight while it is in transit.

On September 29, 2008, Taxpayer submitted a request for refund of B&O tax for the period October 2004 through August 2008, with the following explanation:

We have mistakenly overstated our gross receipts. The amounts reported were based upon loads that moved interstate versus intrastate (origin was in WA destination in other states throughout the US and Canada). We have reported \$. . . of gross receipts; which included the interstate loads. However, the amount that should have been reported is \$. . . for loads that originated and delivered within the state of Washington. We requesting (sic) a refund of \$. . . .

The Taxpayer Account Administration Division (TAA) responded by letter the same day and requested the following additional documentation in order to substantiate Taxpayer's claim for refund:

- A detailed description of Taxpayer's business activities *and*
- Invoices for 2008 illustrating the origination and destination of the loads.

Taxpayer provided a description of its business activities, as listed above, and its 2008 invoices as requested. Taxpayer also provided TAA with a copy of its request for a letter ruling from TI&E as to the proper classification of its business activities in Washington.

On September 30, 2008, TAA asked Taxpayer if it had received a response regarding the proper classification of its business activities. Taxpayer responded that it received a written determination that it must report its business activities under the service and other activities B&O classification, which has a tax rate of .015. Based on this information, TAA advised Taxpayer that it would need to provide "apportionment information" pursuant to WAC 458-20-194. On November 7, 2008, TAA sent Taxpayer a follow-up letter requesting additional information to substantiate Taxpayer's refund claim. Specifically, TAA requested:

- Cost apportionment ratio as outlined in Washington Administrative Code (WAC) 458-20-194 for October 2004 through August 2008.
- Or provide records showing an accurate reflection of the gross income from Washington

activities for October 2004 through August 2008. These records are known as [the] separate accounting method as outlined in WAC 458-20-194.

The letter gave Taxpayer until December 8, 2008, to provide the requested substantiation. The letter advised Taxpayer that failure to provide the requested information within the 90-day statutory time period will result in denial of the refund application.

On November 21, 2008, Taxpayer responded by email and stated that the records requested for separate accounting for October 2004 through August 2008 were already provided to the Department: "This information has been provided in the Washington Gross Revenue Reports (Origin & Destination) sent via email September 30, 2008; which demonstrated the loads that moved within and outside the state of Washington." TAA determined that this did not satisfy their request for information and denied Taxpayer's refund claim by letter dated November 25, 2008, stating as follows: "As the letter you sent on November 21, 2009 did not contain the required requested information, we are unable to substantiate the validity of your refund claim. Therefore, your refund application is denied."

On December 16, 2009, Taxpayer submitted an appeal of the denial of its refund claim for periods 2005 through 2008. On appeal, Taxpayer argues that its income from freight broker and freight forwarding services should be classified as international charter freight brokering income, which would entitle Taxpayer to the lower B&O tax rate of .00275. . . . Taxpayer requests a refund in the amount of \$. . . for periods 2005 through 2008.<sup>2</sup>

A telephonic hearing on this matter was heard on October 14, 2010. We requested clarification at that time as to the basis of Taxpayer's appeal because the refund request stated different reasons than the Appeal Petition. We gave Taxpayer until November 12, 2010, to provide clarification regarding its appeal and records to support its claim. Taxpayer failed to provide any documentation by the close of record on November 12, 2010. We made a courtesy phone call to Taxpayer's senior accountant and sent an email to follow up regarding the additional records and received no response.

## ANALYSIS

### *1. Substantiation of Taxpayer's Refund Claim*

[1] RCW 82.32.170 authorizes taxpayers to file claims for refund with the Department. By administrative rule, the Department has adopted regulations for the administration of such refund claims in WAC 458-20-229 (Rule 229). Under Rule 229(3)(b)(v)), a taxpayer is encouraged to file substantiation documents at the time of the filing of the refund application. Once the application is filed, however, the taxpayer must submit sufficient substantiation to support the

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<sup>2</sup> This preferential tax rate was first enacted in 1979 as former RCW 82.04.260(8) to encourage international trade and retain this type of business in the state. In 1998, the tax rate was reduced from .363 as part of a B&O tax rate consolidation bill for tax simplification purposes. See Washington Special Notice, 6/26/1998 (citing HB 2335, chapter 312, Laws of 1988).

claim for refund before the Department can determine whether the claim is valid. *Id.* The Department will notify the taxpayer if additional substantiation is required. *Id.* Rule 229(3)(b)(vii) states that if the Department does not receive the necessary substantiation within the applicable time period, the Department “shall” deny the claim for lack of adequate substantiation.

In this case, TAA initially notified Taxpayer that it needed a detailed description of its business activities and invoices from 2008 showing the origin and destination of its loads. Taxpayer complied with this request within the time frame given. TAA then sent Taxpayer a follow-up request, which asked for additional records to substantiate its claim. Specifically, TAA requested that Taxpayer provide cost apportionment ratio information as outlined in WAC 458-20-194 (Rule 194) or Taxpayer was given the option of providing records showing an accurate reflection of gross income from Washington activities for the applicable refund claim period. TAA explained in its request that these records are “known as separate accounting.”

Taxpayer chose the latter option. Taxpayer responded to TAA and advised that those records for separate accounting were already provided to the Department in the Washington Gross Revenue Reports attached to its email to TAA on September 30, 2008. The Washington Gross Revenue Reports provided to TAA showed the gross revenue that Taxpayer originally reported on its combined excise tax returns and gross revenue from purely intrastate loads. Because this information does not comply with the approved separate accounting methods . . . we find that TAA properly denied Taxpayer’s refund claim for lack of substantiation. Rather than accurately describing its gross income attributable to Washington activities, the information Taxpayer provided was really no more than another way of attempting to claim the interstate and foreign sales deduction addressed below.

## 2. Interstate Sales Deduction

[2] With its refund application, Taxpayer claimed it was entitled to a refund for overpayment of B&O tax based on its belief that it had erroneously reported income from interstate loads. . . .

Pursuant to WAC 458-20-193D (Rule 193D), there is a narrow deduction allowed for income derived from the interstate segment of the interstate transportation of commodities under a specific set of facts. However, Rule 193D clearly states that “[n]o deduction is permitted with respect to the gross income derived from activities which are ancillary to transportation across the state’s boundaries . . . .” *See also* Det. No. 00-057, 19 WTD 986 (2000). Thus, while it is possible that freight forwarding of interstate loads may be deductible if Taxpayer assumed responsibility for the actual transportation,<sup>3</sup> the great majority of Taxpayer’s business activities

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<sup>3</sup> Title 82 RCW, chapter 458-20 WAC, and the ETAs do not define “freight forwarder.” The usual rule of statutory construction is to resort to a dictionary for the ordinary meaning of a word in the absence of a definition supplied by the legislature. *Dawson v. Daly*, 120 Wn.2d 782, 791, 845 P.2d 995 (1993).<sup>3</sup> Webster’s New World Dictionary (Second College Edition 1972) defines “forwarder” to mean:

A person or agency that receives goods and expedites their delivery, as by arranging for warehousing, shipping in carload lots, transshipping, etc.

were freight brokering,<sup>4</sup> which is not deductible. *See* ETA 3149.2009.

In any event, in this case, Taxpayer has failed to provide records of *actual* interstate transportation of property. Without documentation to support that it did more than ancillary services to support the interstate transportation of goods, we find that Taxpayer is not entitled to a deduction for interstate transportation under Rule 193D and ETA 3149.2009. . . .

#### 4. *Classification of Taxpayer's Gross Receipts from Domestic Freight Brokering and Freight Forwarding Activities*

[3] As to the proper classification of Taxpayer's income, we note that Taxpayer did not challenge the classification of its income as service and other activities with its refund request. However, because the statute of limitations has not expired for the years Taxpayer has requested a refund on appeal, we find it appropriate to address this issue.

Washington imposes a business and occupation (B&O) tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. Det. No. 02-213, 23 WTD 32 (2004) (citing RCW 82.04.290). The service & other activities B&O tax classification under RCW 82.04.290(2) is a very broad classification that includes all business activities except those which have a specific B&O tax classification set forth elsewhere in the tax

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Black's Law Dictionary 64 (Rev. 7th Ed. 1999), provides a definition of freight forwarder or forwarder as a "forwarding agent":

A person or company whose business is to receive and ship goods for others. – Also termed *freight-forwarder*.

The Washington State Utilities & Transportation Commission (UTC), the regulator of freight forwarders engaged in intrastate commerce, defines "forwarder" in its rules on "motor carriers," in WAC 480-12-100(9):

For the purpose of these rules a "forwarder" shall be defined as a person engaged in the business of soliciting, collecting or assembling shipments for the purpose of combining the same into a shipment of such size as to be entitled to a quantity rate and who forwards such shipment in his own name and at his own risk by a common carrier at such quantity rate.

We find another definition of "freight forwarder" in the Interstate Commerce Act, the regulation of freight forwarders engaged in interstate commerce, at 49 U.S.C. §10102(9) states:

"[F]reight forwarder" means a person holding itself out to the general public (other than as an express, pipeline, rail, sleeping car, motor, or water carrier) to provide transportation of property for compensation and in the ordinary course of its business --

- (A) assembles and consolidates, or provides for assembling and consolidating, shipments and performs or provides for break-bulk and distribution operations of the shipments;
- (B) assumes responsibility for the transportation from the place of receipt to the place of destination; and
- (C) uses for any part of the transportation a carrier subject to the jurisdiction of the Interstate Commerce Commission under subchapter I, II or III of chapter 105 of this title.

<sup>4</sup> A broker is "an agent who acts as an intermediary or negotiator, esp. between prospective buyers and sellers; a person employed to make bargains and contracts between other persons in matters of trade, commerce and navigation." Black's Law Dictionary 187 (Rev. 7<sup>th</sup> ed. 1999).

code. For businesses that perform services or other business activities, the B&O tax is equal to the gross income of the business multiplied by the rate of 1.5 percent. RCW 82.04.290.<sup>5</sup>

Taxpayer argues that some of its business activities in Washington fall within the specific B&O tax classification for international charter freight brokers or international freight forwarders found in RCW 82.04.260(5). RCW 82.04.260 provides in relevant part:

(5) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, *international* freight forwarder, vessel and/or cargo charter broker *in foreign commerce*, and/or *international* air cargo agent; as to such persons the amount of the tax *with respect to only international activities* is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(Emphasis added).<sup>6</sup> In order to qualify for the lower preferential tax rate under RCW 82.04.260, Taxpayer must show that it engaged in *international* freight brokering or forwarding.

While Taxpayer may have provided documentation of freight forwarding and freight brokering activities; it has failed to show that it was engaged in those activities internationally. Therefore, Taxpayer's petition to have its income reclassified is denied.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 14th day of December 2010.

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<sup>5</sup> Effective May 1, 2010, the Legislature approved a temporary B&O tax increase for business activities under the service and other activities classification, which brought the rate to 1.8 percent. *See* 2ESSB 6143 (Section 1101).

<sup>6</sup> This preferential tax rate was first enacted in 1979 as former RCW 82.04.260(8) to encourage international trade and retain this type of business in the state. In 1998, the tax rate was reduced from .363 as part of a B&O tax rate consolidation bill for tax simplification purposes. *See* Washington Special Notice, 6/26/1998 (citing HB 2335, chapter 312, Laws of 1988).